

**EXPECTED RATINGS:** Moody's: Aaa  
S&P: AAA  
Fitch: AAA  
(See "RATINGS" herein)

*In the opinion of Hawkins, Delafield & Wood, Bond Counsel, under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, interest on the Offered Veterans G.O. Bonds (a) is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and (b) is not treated as a preference item for purposes of calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In addition, in the opinion of Bond Counsel, under existing statutes, interest on the Offered Veterans G.O. Bonds is exempt from State of California personal income taxes. See "TAX MATTERS" herein.*

**\$42,000,000**

**STATE OF CALIFORNIA  
VETERANS GENERAL OBLIGATION BONDS  
Series BX (Non-AMT)**

This offering consists of veterans general obligation bonds listed above (the "Offered Veterans G.O. Bonds") authorized by the voters of the State of California (the "State").

Interest is payable on June 1 and December 1 of each year, commencing December 1, 2001. The Offered Veterans G.O. Bonds may be purchased in book-entry form only, in the principal amount of \$5,000 or any integral multiples thereof. See APPENDIX C — "BOOK-ENTRY SYSTEM." The Offered Veterans G.O. Bonds are subject to redemption prior to maturity, including redemption at par. See "THE OFFERED VETERANS G.O. BONDS — Redemption."

**MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES, DATED DATE, AND PRICES OR YIELDS**  
(see inside cover page)

The Offered Veterans G.O. Bonds are general obligations of the State to which the full faith and credit of the State are pledged. Principal of, premium, if any, and interest on the Offered Veterans G.O. Bonds are payable from any moneys in the General Fund of the State, subject only to the prior application of such moneys to the support of the public school systems and public institutions of higher education. State law requires funds for the payment of debt service on the Offered Veterans G.O. Bonds to be transferred to the General Fund from the Veterans Farm and Home Building Fund of 1943. See "AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS — Security For and Payment of Veterans G.O. Bonds."

The scheduled payment of principal of and interest on the Offered Veterans G.O. Bonds when due will be guaranteed under an insurance policy to be issued concurrently with the delivery of the Offered Veterans G.O. Bonds by Financial Security Assurance Inc. ("FSA"). See "OFFERED VETERANS G.O. BONDS MUNICIPAL BOND INSURANCE POLICY."



This cover page contains certain information for quick reference only. It is not a summary of this issue. Investors must read the entire Official Statement to obtain information essential to the making of an informed investment decision.

The Offered Veterans G.O. Bonds (other than the Offered Veterans G.O. Bonds maturing December 1, 2025 and December 1, 2032, which are not being reoffered hereby) are offered when, as and if issued and received by the Underwriters set forth below, subject to certain conditions, including the receipt of certain legal opinions of The Honorable Bill Lockyer, Attorney General of the State of California, and of Hawkins, Delafield & Wood, Bond Counsel to the State. In connection with the issuance of the Offered Veterans G.O. Bonds, Public Resources Advisory Group has served as Financial Advisor, Quateman & Zidell LLP has served as Disclosure Counsel to the State, and Orrick, Herrington & Sutcliffe LLP has served as Special Counsel to the State regarding APPENDIX A. Certain legal matters will be passed upon for the Underwriters by their counsel, Kutak Rock LLP. The Offered Veterans G.O. Bonds will be available for delivery on or about June 20, 2001.

**Honorable Philip Angelides  
Treasurer of the State of California**

**Merrill Lynch & Co.**

**Bear, Stearns & Co. Inc.**

**Banc of America Securities LLC**

**Great Pacific Securities, Inc.**

**Pacific American Securities LLC**

**Dain Rauscher Incorporated**

**J.P. Morgan & Co.**

**Roberts & Ryan Investments Inc.**

**Sutro & Co. Incorporated**

**Lehman Brothers**

**Goldman, Sachs & Co.**

**Mischler Financial Group, Inc.**

**Salomon Smith Barney**

**MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES,  
DATED DATE, AND PRICES OR YIELDS**

**\$42,000,000 Veterans General Obligation Bonds Series BX (Non-AMT)**

**\$4,805,000 Serial Bonds**

<u>Date (December 1)</u>	<u>Maturity Principal Amount</u>	<u>Interest Rate</u>	<u>Price or Yield</u>	<u>CUSIP Number</u>
2005	\$ 100,000	3.75%	100%	13062NUJ4
2006	100,000	3.90	100	13062NUK1
2007	100,000	4.05	100	13062NUL9
2008	100,000	4.20	100	13062NUM7
2009	100,000	4.30	100	13062NUN5
2010	1,010,000	4.40	100	13062NUP0
2011	1,050,000	4.55	100	13062NUQ8
2012	1,100,000	4.70	100	13062NUR6
2013	1,145,000	4.80	100	13062NUS4

**\$9,790,000 5.35% Term Bonds due December 1, 2020; Price: 100% CUSIP No. 13062NUT2**

**\$5,430,000 5.45% Term Bonds due December 1, 2024; Price: 100% CUSIP No. 13062NUU9**

**\$4,000,000 5.45% Term Bonds due December 1, 2025; Price: 100% CUSIP No. 13062NUV7 (Not Reoffered)**

**\$6,975,000 5.50% Term Bonds due December 1, 2031; Price: 100% CUSIP No. 13062NUW5**

**\$11,000,000 5.50% Term Bonds due December 1, 2032; Price: 100% CUSIP No. 13062NUX3 (Not Reoffered)**

(plus accrued interest from Dated Date of June 1, 2001)

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Copies of this Official Statement may be obtained from:

**HONORABLE PHILIP ANGELIDES**

Treasurer of the State of California  
P.O. Box 942809  
Sacramento, California 94209-0001  
(800) 900-3873

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## **OFFICIAL STATEMENT**

**\$42,000,000**

### **STATE OF CALIFORNIA VETERANS GENERAL OBLIGATION BONDS Series BX (Non-AMT)**

#### **INTRODUCTION**

*This Introduction contains only a brief summary of the terms of the State of California Veterans General Obligation Bonds listed above (the "Offered Veterans G.O. Bonds") and a brief description of the Official Statement; a full review should be made of the entire Official Statement, including the Appendices and information incorporated by reference. All statements contained in this introduction are qualified in their entirety by reference to the entire Official Statement. Summaries of provisions of the Constitution and laws of the State of California or any other documents referred to in this Official Statement do not purport to be complete and such summaries are qualified in their entirety by references to the complete provisions.*

#### **Description of the Offered Veterans G.O. Bonds**

The issuance of veterans general obligation bonds ("Veterans G.O. Bonds") is authorized by Bond Acts (defined below) approved by the voters of the State of California (the "State") and by resolutions of the Veterans Finance Committee of 1943. The Offered Veterans G.O. Bonds are authorized by a specific Bond Act and are being issued to finance, or to refinance obligations that were issued to provide funds for the financing of, contracts ("Contracts of Purchase") for the purchase of homes and farms for California military veterans under the Farm and Home Purchase Program (the "Program") of the Department of Veterans Affairs of the State (the "Department"). The Offered Veterans G.O. Bonds are being issued for the purpose of refunding certain outstanding Veterans G.O. Bonds, one consequence of which will be that some moneys will become available to finance new Contracts of Purchase between the Department and eligible veterans. See "THE OFFERED VETERANS G.O. BONDS – Purpose" and "– Identification and Authorization of the Offered Veterans G.O. Bonds."

The issuance of the Offered Veterans G.O. Bonds is expected to result in moneys becoming available for new Contracts of Purchase. See EXHIBIT 2 to APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts Of Purchase – Amounts Expected To Be Available To Fund Contracts of Purchase and Related Investments."

The Offered Veterans G.O. Bonds will be registered in the name of a nominee of The Depository Trust Company ("DTC") which will act as securities depository for the Offered Veterans G.O. Bonds. Purchases of beneficial interests in the Offered Veterans G.O. Bonds may be in book-entry form only, in the principal amount of \$5,000 or any integral multiple thereof. Principal and interest are payable as specified on the front cover page and inside front cover page of this Official Statement.

#### **Security for and Sources of Payment for Veterans G.O. Bonds**

The Offered Veterans G.O. Bonds are general obligations of the State to which the full faith and credit of the State are pledged (see "AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS – Security For and Payment of Veterans G.O. Bonds" herein). Principal of and interest on the Veterans G.O. Bonds are payable from moneys in the General Fund of the State Treasury (the "General Fund") (see APPENDIX A – "THE STATE OF CALIFORNIA – State Finances – The General Fund"), subject only to the prior application of moneys in the General Fund to the support of the public school system and public institutions of higher education. The Bond Acts authorizing the Offered Veterans G.O. Bonds provide that the State shall collect annually, in the same manner and at the same time as it collects other State revenues, a sum sufficient, in addition to the ordinary revenues of the State, to pay the principal of and interest on the Offered Veterans G.O. Bonds. State law requires funds for the payment

of debt service on the Offered Veterans G.O. Bonds to be transferred to the General Fund from the Veterans Farm and Home Building Fund of 1943 (the "1943 Fund"). See "AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS – Security For and Payment of Veterans G.O. Bonds" and APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA. THE PROGRAM AND THE 1943 FUND."

### **Offered Veterans G.O. Bonds Are Insured Under a Municipal Bond Insurance Policy**

Concurrently with, and as a condition precedent to, the issuance of the Offered Veterans G.O. Bonds, there will be delivered an insurance policy (the "Offered Veterans G.O. Bonds Municipal Bond Insurance Policy") issued by Financial Security Assurance Inc. ("FSA") guaranteeing the scheduled payment of principal of and interest on the Offered Veterans G.O. Bonds. See "THE OFFERED VETERANS G.O. BONDS MUNICIPAL BOND INSURANCE POLICY" and APPENDIX H – "FORM OF OFFERED VETERANS G.O. BONDS MUNICIPAL BOND INSURANCE POLICY OF FINANCIAL SECURITY ASSURANCE INC."

### **Redemption**

The Offered Veterans G.O. Bonds are subject to optional and special redemption prior to maturity. In addition, the Offered Veterans G.O. Bonds maturing on December 1, 2020, December 1, 2024, December 1, 2025, December 1, 2031, and December 1, 2032 are subject to mandatory redemption at par prior to their stated maturities, in part, from sinking fund payments made by the State. See "THE OFFERED VETERANS G.O. BONDS – Redemption."

### **Information Related to this Official Statement**

The information set forth herein has been obtained from official sources which are believed to be reliable, but it is not guaranteed as to accuracy or completeness. The information and expressions of opinion herein are subject to change without notice, and neither delivery of this Official Statement nor any sale made hereunder or any future use of this Official Statement shall, under any circumstances, create any implication that there has been no change in the affairs of the State or the Department since the date hereof.

All financial and other information presented or incorporated by reference in this Official Statement has been provided by, respectively, the State or the Department from its records, *except* for information expressly attributed to other sources. The presentation of information, including tables of receipts from taxes and other revenues, is intended to show recent historic information and is not intended to indicate future or continuing trends in the financial position or other affairs of, respectively, the State or the Department. No representation is made that past experience, as it might be shown by such financial and other information, will necessarily continue or be repeated in the future. Any statements made in this Official Statement involving matters of opinion, projections or estimates, whether expressly stated or not, are set forth as such and not as representations of fact.

A wide variety of other information, including financial information, concerning the State is available from State agencies, State agency publications, and State agency websites. Any such information that is inconsistent with the information set forth in this Official Statement should be disregarded. No such information is a part of or incorporated into this Official Statement, except as expressly noted. See "FINANCIAL STATEMENTS" and APPENDIX A– "THE STATE OF CALIFORNIA– Financial Statements."

The information in APPENDIX C– "BOOK-ENTRY SYSTEM" has been furnished by The Depository Trust Company and no representation is made by the State, the Underwriters, the Financial Advisor, or the purchasers of the Offered Veterans G.O. Bonds as to the accuracy or completeness of such information.

Other than with respect to information concerning FSA contained under the caption "OFFERED VETERANS G.O. BONDS MUNICIPAL BOND INSURANCE POLICY" and APPENDIX H - "FORM OF OFFERED VETERANS G.O. BONDS MUNICIPAL BOND INSURANCE POLICY OF FINANCIAL SECURITY ASSURANCE INC." herein, none of the information in this Official Statement has been supplied or verified by FSA and FSA makes no representation or warranty, express or implied, as to (i) the accuracy or completeness of such information; (ii) the validity of the Offered Veterans G.O. Bonds; or (iii) the tax exempt status of the interest on the Offered Veterans G.O. Bonds.

This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of the Offered Veterans G.O. Bonds by any person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation, or sale.

No dealer, broker, salesperson or other person has been authorized by the State to give any information or to make any representations other than those contained herein and, if given or made, such other information or representations must not be relied upon as having been authorized by the State. This Official Statement is not to be construed as a contract with the purchasers of the Offered Veterans G.O. Bonds.

IN CONNECTION WITH THE OFFERING OF THE OFFERED VETERANS G.O. BONDS (OTHER THAN THE OFFERED VETERANS G.O. BONDS MATURING DECEMBER 1, 2025 AND DECEMBER 1, 2032 (THE "PLACED BONDS"), WHICH ARE NOT BEING REOFFERED HEREBY), THE UNDERWRITERS MAY OVER ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE OFFERED VETERANS G.O. BONDS OFFERED HEREBY AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

### **Tax Matters**

In the opinion of Hawkins, Delafield & Wood, Bond Counsel to the State ("Bond Counsel"), under existing statutes and court decisions, assuming compliance by the State and the Department with certain tax covenants described therein, interest on the Offered Veterans G.O. Bonds (i) is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and such interest is exempt from personal income taxes of the State of California under present State law, and (ii) is not treated as a preference item for purposes of calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, *however*, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. See "TAX MATTERS" below, APPENDIX E - "CERTAIN FEDERAL TAX CODE REQUIREMENTS" and APPENDIX G - "LEGAL OPINION OF BOND COUNSEL."

### **Continuing Disclosure**

The State Treasurer, on behalf of the State, will provide annually to certain nationally recognized municipal securities information repositories certain financial information and operating data relating to the State for each Fiscal Year in which any Offered Veterans G.O. Bonds are outstanding (the "Treasurer's Annual Report"), by not later than April 1 of the calendar year following the end of such Fiscal Year, commencing with the report for the 2000-2001 Fiscal Year, and to provide notices of the occurrence of certain other enumerated events if material. The Secretary of the Department will provide annually to certain nationally recognized municipal securities information repositories certain financial information and operating data relating to the Program for each Fiscal Year in which any Offered Veterans G.O. Bonds are outstanding (the "Department's Annual Report"), by not later than April 1 of the calendar year following the end of such Fiscal Year, commencing with the report for the 2000-2001 Fiscal Year. The specific nature of the information to be contained in the Treasurer's Annual Report and the

Department's Annual Report or the notices of material events and certain other terms of the continuing disclosure obligations are summarized below under APPENDIX D – "SUMMARY OF CONTINUING DISCLOSURE CERTIFICATES."

Neither the State Treasurer nor the Secretary of the Department has failed to comply, in any material respect, with any "previous undertakings," as that term is used in Rule 15c2-12 promulgated under the Securities Exchange Act of 1934, as amended.

#### **Additional Information**

A variety of other information, including financial information, concerning the State is available from State agencies, State agency publications, and State agency websites. No such information is a part of or incorporated into this Official Statement, except as expressly noted. Any such information that is inconsistent with the information set forth in this Official Statement should be disregarded. See APPENDIX A – "THE STATE OF CALIFORNIA – Financial Statements."

Questions regarding this Official Statement and the issuance of these securities may be addressed to the Office of the Honorable Philip Angelides, Treasurer of the State of California, P.O. Box 942809, Sacramento, California 94209-0001, telephone (800) 900-3873. Questions regarding the Program should be addressed to the Bond Finance Division of the Department of Veterans Affairs, P.O. Box 942895, Sacramento, California 94295-0001, telephone (916) 653-2081.

### **AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS**

#### **Authorization**

Each general obligation bond act authorizing the issuance of Veterans G.O. Bonds (each, a "Bond Act") incorporates by reference the State General Obligation Bond Law (the "Law"), which is set forth in Chapter 4 (commencing with Section 16720) of Part 3 of Division 4 of Title 2 of the California Government Code. The Law provides a procedure for the authorization, sale, issuance, use of proceeds, repayment, and refunding of State general obligation bonds.

\$647,585,000 of new issue Veterans G.O. Bonds are authorized under Bond Acts but not issued. The Offered Veterans G.O. Bonds will use \$42,000,000 of such \$647,585,000 authorization. See APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – THE 1943 FUND – General".

#### **Security For and Payment of Veterans G.O. Bonds**

The Veterans G.O. Bonds are general obligations of the State, payable in accordance with the Bond Acts out of the General Fund. The full faith and credit of the State are pledged for the punctual payment of the principal of and the interest on the Veterans G.O. Bonds. All payments of principal, premium, if any, and interest on all State general obligation bonds, including the Offered Veterans G.O. Bonds, have an equal claim to the General Fund, subject only to the prior application of moneys in the General Fund to the support of the public school systems and public institutions of higher education. The Bond Acts provide that the State shall collect annually in the same manner and at the same time as it collects other State revenue an amount sufficient, in addition to the ordinary revenue of the State, to pay principal of and interest on the Veterans G.O. Bonds. The Bond Acts also contain a continuing appropriation from the General Fund of the sum annually necessary to pay the principal of and the interest on the Veterans G.O. Bonds as they become due and payable.

The Department's principal fund is the 1943 Fund described in APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – THE 1943 FUND." The Military and Veterans Code of the State (the "Veterans Code"), of which the Bond Acts are

a part, requires that on the dates when funds are to be remitted to bondowners for the payment of debt service on Veterans G.O. Bonds in each fiscal year, there shall be transferred to the General Fund to pay the debt service on Veterans G.O. Bonds all of the money in the 1943 Fund (but not in excess of the amount of debt service then due and payable). If the money so transferred on the remittance dates is less than the debt service then due and payable, the balance remaining unpaid is required by the Veterans Code to be transferred to the General Fund out of the 1943 Fund as soon as it shall become available, together with interest thereon from the remittance date until paid, at the same rate of interest as borne by the applicable Veterans G.O. Bonds, compounded semiannually.

The Veterans Code does not grant any lien on the 1943 Fund or the moneys therein to the holders of any Veterans G.O. Bonds. As of April 1, 2001, there were outstanding \$2,419,070,000 aggregate principal amount of Veterans G.O. Bonds, not including the Offered Veterans G.O. Bonds. Outstanding Home Purchase Revenue Bonds in the aggregate principal amount of \$538,435,000 (as of April 1, 2001) previously issued by the Department (collectively with any additional Home Purchase Revenue Bonds issued by the Department in the future, the "Revenue Bonds") are and will be special obligations of the Department payable solely from, and secured by a pledge of, an undivided interest in the assets of the 1943 Fund (other than proceeds of Veterans G.O. Bonds or any amounts in any rebate account) and any reserve accounts established for the benefit of Revenue Bonds. The Veterans Code provides that this undivided interest in the 1943 Fund is secondary and subordinate to any interest or right in the assets of the 1943 Fund of the people of the State and of the holders of the Veterans G.O. Bonds (that is, the right to payment or reimbursements of debt service on Veterans G.O. Bonds described in the preceding paragraph). If debt service payments to the General Fund are current and all reimbursement of debt service payments with interest as described in the preceding paragraph has been made, no holder or beneficial owner of Veterans G.O. Bonds has any right to restrict disbursements by the Department from the 1943 Fund for any lawful purpose, including payment of debt service on or redemptions and purchases of Revenue Bonds.

For additional information, see APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – THE 1943 FUND" and EXHIBIT 1 to APPENDIX B – "FINANCIAL STATEMENTS OF THE 1943 FUND FOR FISCAL YEARS 2000 AND 1999 AND INDEPENDENT AUDITORS' REPORT."

### **OFFERED VETERANS G.O. BONDS MUNICIPAL BOND INSURANCE POLICY**

#### **General**

The Offered Veterans G.O. Bonds are expected to be the subject of an Offered Veterans G.O. Bonds Municipal Bond Insurance Policy described under this heading to be issued by FSA.

The information relating to FSA and the Offered Veterans G.O. Bonds Municipal Bond Insurance Policy contained below under the subcaption "Financial Security Assurance Inc." has been furnished by FSA and neither the State, the Department, nor the Underwriters have undertaken any independent investigation of FSA, its operations, or its municipal bond insurance. No representation is made herein as to the accuracy or adequacy of such information or as to the absence of material adverse changes in such information subsequent to the date hereof. Neither the State, the Department, nor the Underwriters make any representation as to the ability of FSA to make payments under the Offered Veterans G.O. Bonds Municipal Bond Insurance Policy. See Appendix H – "FORM OF OFFERED VETERANS G.O. BONDS MUNICIPAL BOND INSURANCE POLICY OF FINANCIAL SECURITY ASSURANCE INC."

## **Municipal Bond Insurance Policy**

Concurrently with the issuance of the Offered Veterans G.O. Bonds, FSA will issue its Municipal Bond Insurance Policy for the Offered Veterans G.O. Bonds (the "Offered Veterans G.O. Bonds Municipal Bond Insurance Policy"). The Offered Veterans G.O. Bonds Municipal Bond Insurance Policy guarantees the scheduled payment of principal of and interest on the Offered Veterans G.O. Bonds when due as set forth in the form of the Offered Veterans G.O. Bonds Municipal Bond Insurance Policy included in Appendix H to this Official Statement.

The Offered Veterans G.O. Bonds Municipal Bond Insurance Policy is not covered by any security or guaranty fund established under New York, California, Connecticut or Florida insurance law.

## **Financial Security Assurance Inc.**

FSA is a New York domiciled insurance company and a wholly owned subsidiary of Financial Security Assurance Holdings Ltd. ("Holdings"). Holdings is an indirect subsidiary of Dexia, S.A., a publicly held Belgian corporation. Dexia, S.A., through its bank subsidiaries, is primarily engaged in the business of public finance in France, Belgium and other European countries. No shareholder of Holdings or FSA is liable for the obligations of FSA.

At March 31, 2001, FSA's total policyholders' surplus and contingency reserves were approximately \$1,430,595,000 and its total unearned premium reserve was approximately \$730,490,000 in accordance with statutory accounting principles. At March 31, 2001, FSA's total shareholders' equity was approximately \$1,547,252,000 and its total net unearned premium reserve was approximately \$600,774,000 in accordance with generally accepted accounting principles.

The financial statements included as exhibits to the annual and quarterly reports filed by Holdings with the Securities and Exchange Commission are hereby incorporated herein by reference. Also incorporated herein by reference are any such financial statements so filed from the date of this Official Statement until the termination of the offering of the Offered Veterans G.O. Bonds. Copies of materials incorporated by reference will be provided upon request to Financial Security Assurance Inc., 350 Park Avenue, New York, New York 10022, Attention: Communications Department (telephone: (212) 826-0100).

The Offered Veterans G.O. Bonds Municipal Bond Insurance Policy does not protect investors against changes in market value of the Offered Veterans G.O. Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. FSA makes no representation regarding the Offered Veterans G.O. Bonds or the advisability of investing in the Offered Veterans G.O. Bonds. FSA makes no representation regarding the Official Statement, nor has it participated in the preparation thereof, except that FSA has provided to the State and the Department the information presented under this caption for inclusion in the Official Statement.

## **THE OFFERED VETERANS G.O. BONDS**

### **General**

The Offered Veterans G.O. Bonds will be registered in the name of the nominee of The Depository Trust Company ("DTC"), which will act as securities depository for the Offered Veterans G.O. Bonds. Purchases of beneficial interests in the Offered Veterans G.O. Bonds may be made in book-entry form only, in the principal amount of \$5,000 or any integral multiple thereof. See APPENDIX C - "BOOK-ENTRY SYSTEM."

The Offered Veterans G.O. Bonds will be dated the Dated Date and will mature on the dates and in the amounts set forth on the inside front cover page hereof. Interest on the Offered Veterans G.O.

Bonds will accrue from June 1, 2001 at the respective rates shown on the inside front cover page of this Official Statement. Interest on the Offered Veterans G.O. Bonds is payable on June 1 and December 1 in each year (each, an "Interest Payment Date") commencing December 1, 2001 and shall be calculated on the basis of a 360-day year comprised of twelve thirty-day months.

Principal and interest are payable directly to DTC by the State Treasurer. Upon receipt of payments of principal and interest, DTC is to in turn remit such principal and interest to the participants in DTC for disbursement to the beneficial owners of the Offered Veterans G.O. Bonds. The record date for the payment of interest on the Offered Veterans G.O. Bonds is the close of business on the 15th day of the month immediately preceding an Interest Payment Date, whether or not the record date falls on a business day.

In reading this Official Statement it should be understood that while the Offered Veterans G.O. Bonds are in the Book-Entry-Only System, (i) all rights of ownership must be exercised through DTC and the Book-Entry-Only System, and (ii) notices that are to be given to registered owners by the State will be given only to DTC.

### **Purpose**

Under the Program, the Department acquires residential property to be sold to eligible veterans under Contracts of Purchase between the Department and such veterans. Such acquisition is financed principally with the proceeds of Veterans G.O. Bonds and the Department's Revenue Bonds. The Offered Veterans G.O. Bonds are being issued for the purpose of refunding certain outstanding Veterans G.O. Bonds, one consequence of which will be that some moneys will become available to finance new Contracts of Purchase between the Department and eligible veterans.

See EXHIBIT 2 to APPENDIX B - "DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND - Certain Department Financial Information and Operating Data - Contracts of Purchase - Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments."

### **Identification and Authorization of the Offered Veterans G.O. Bonds**

The Offered Veterans G.O. are issued under the Veterans Bond Act of 1996, authorized by the voters of the State. See APPENDIX A - "THE STATE OF CALIFORNIA - State Indebtedness."

### **Redemption**

#### *Sinking Fund Redemption*

The Offered Veterans G.O. Bonds maturing on December 1, 2020, December 1, 2024, December 1, 2025, December 1, 2031, and December 1, 2032 (the "Term Bonds") are subject to redemption prior to their respective stated maturity dates, in part, by lot, from sinking fund payments, at a redemption price of 100 percent of the principal amount thereof, plus accrued interest to the date fixed for redemption, without premium, on the respective dates and in the respective amounts shown below.

## SINKING FUND REDEMPTION SCHEDULE

<u>December 1</u>	<u>Series BX Bonds Maturing December 1, 2020</u>	<u>Series BX Bonds Maturing December 1, 2024</u>	<u>Series BX Bonds Maturing December 1, 2025</u>	<u>Series BX Bonds Maturing December 1, 2031</u>	<u>Series BX Bonds Maturing December 1, 2032</u>
2014	\$1,200,000				
2015	1,255,000				
2016	1,325,000				
2017	1,390,000				
2018	1,465,000				
2019	1,535,000				
2020	1,620,000 <sup>†</sup>				
2021		\$1,255,000	\$ 445,000		
2022		1,320,000	470,000		
2023		1,390,000	490,000		
2024		1,465,000 <sup>†</sup>	515,000		
2025			2,080,000 <sup>†</sup>		
2026				\$1,020,000	\$1,170,000
2027				1,070,000	1,235,000
2028				1,130,000	1,295,000
2029				1,190,000	1,365,000
2030				1,250,000	1,440,000
2031				1,315,000 <sup>†</sup>	1,515,000
2032					2,980,000 <sup>†</sup>

<sup>†</sup> Stated Maturity.

If less than all of the Term Bonds of the same maturity date are purchased or called for redemption (other than in satisfaction of sinking fund payments), the State Treasurer will credit the principal amount of such Term Bonds that are so purchased or redeemed against applicable remaining sinking fund payments relating to such Term Bonds (including the principal amounts due on the respective maturity dates, as shown above), as requested by the Department.

### *Optional Redemption*

The Offered Veterans G.O. Bonds maturing on or after December 1, 2006 are subject to optional redemption prior to their respective stated maturity dates, at the option of the State upon request of the Department, in whole or in part (of any maturity and by lot within each maturity), on any date on or after June 1, 2006 at the redemption prices stated below, plus accrued interest to the date fixed for redemption:

<u>Redemption Dates (both dates inclusive)</u>	<u>Redemption Price (as percentage of principal amount redeemed)</u>
June 1, 2006 to May 31, 2007	101%
June 1, 2007 and thereafter	100%



### *Special Redemption from Excess Revenues*

The Offered Veterans G.O. Bonds are subject to special redemption on any date prior to their respective stated maturity dates, at the option of the State upon request of the Department, from Excess Revenues (as defined below) derived from any Veterans G.O. Bonds or any Revenue Bonds. Any such redemption may be in whole or in part (and of any maturity at the option of the State upon request of the Department and by lot within such maturity), at the principal amount thereof plus accrued interest to the date fixed for redemption, without premium.

"Excess Revenues" means, as of any date of calculation, Revenues in excess of Accrued Debt Service. Excess Revenues can include prepayments and repayments on Contracts of Purchase funded by Revenue Bonds and Veterans G.O. Bonds, and also includes Revenues which had been set aside to be recycled into new Contracts of Purchase. All payments on Contracts of Purchase are deposited in the 1943 Fund and applied to pay or reimburse debt service on the Veterans G.O. Bonds, to pay debt service on Revenue Bonds, to pay for mandatory redemptions of Veterans G.O. Bonds and Revenue Bonds, to pay Program and Department expenses, and to pay certain insurance claims. The Department, subject to applicable bond authorizing resolutions, may apply Excess Revenues to redeem any Veterans G.O. Bonds or Revenue Bonds eligible for redemption. The Department's decision to apply Excess Revenues to redeem bonds, to finance new Contracts of Purchase, or for any other permitted purpose depends on many factors, including applicable bond authorizing resolution requirements, demand for Contracts of Purchase, debt service cost savings, investment earnings, and Federal Tax Code requirements. See APPENDIX B - "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND - THE 1943 FUND - Excess Revenues."

Certain of the outstanding Veterans G.O. Bonds are not subject to redemption prior to maturity. See EXHIBIT 2 to APPENDIX B - "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND - CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA."

The Department's actual past prepayment experience for existing Contracts of Purchase is set forth in EXHIBIT 2 to APPENDIX B - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Contracts of Purchase - Contracts of Purchase Origination and Principal Repayment Experience." However, since the Department substantially reduced the interest rates on most existing Contracts of Purchase in January 1999, the prepayment experience reflected in the chart may not predict the future behavior of such Contracts of Purchase after the interest rate reduction.

For certain Revenue Bonds issued or to be issued after 1988, the Federal Tax Code prohibits repayments (including prepayments) of principal of Contracts of Purchase financed with the proceeds of an issue of such bonds to be used to make additional Contracts of Purchase after 10 years from the date of issuance of such bonds (or the date of issuance of original bonds in the case of refundings), after which date such amounts must be used to redeem such bonds of the issue, except for a \$250,000 *de minimis* amount. See "TAX MATTERS - Federal Tax Matters - Proposed Federal Tax Legislation."

The Federal Tax Code requires a payment to the United States from certain veterans whose Contracts of Purchase are originated after December 31, 1990 with the proceeds of certain Revenue Bonds. Since such requirement remains in effect with respect to any Contracts of Purchase originated after December 31, 1990 with proceeds of the applicable Revenue Bonds for a period ending nine years after the execution of such Contracts of Purchase, the Department is unable to predict what effect, if any, such requirement will have on the origination or prepayment of Contracts of Purchase to which such provision applies.

### **Notice of Redemption**

When redemption is required while the Offered Veterans G.O. Bonds are in book-entry form, the State Treasurer is to give notice of redemption by mailing copies of such notice only to DTC (not to the beneficial owners of the Offered Veterans G.O. Bonds) not less than thirty or more than sixty days prior to

the date fixed for redemption. DTC, in turn, is to send the notice of redemption to its participants for distribution to the beneficial owners of the Offered Veterans G.O. Bonds. See APPENDIX C – "BOOK ENTRY SYSTEM." The notice will state, among other things, that the Offered Veterans G.O. Bonds or a designated portion thereof (in the case of partial redemption of an Offered Veterans G.O. Bond) are to be redeemed, the dated date of the Offered Veterans G.O. Bonds, the redemption date, the maturities of the Offered Veterans G.O. Bonds to be redeemed and the redemption price. The notice will also state that after the date fixed for redemption, no further interest will accrue on the principal of any Offered Veterans G.O. Bonds called for redemption. Notice of redemption will also be provided by mail to certain financial information services and securities depositories.

## **TAX MATTERS**

### **Federal Tax Matters**

Proceeds of the Offered Veterans G.O. Bonds must be used to retire outstanding bonds within ninety days of their respective dates of issuance. Failure to so use all of such proceeds and to comply with other requirements of the Federal Tax Code could cause interest on the Offered Veterans G.O. Bonds to be included in gross income for Federal income tax purposes retroactive to their date of issuance.

#### *Requirements Imposed on the Offered Veterans G.O. Bonds by the Federal Tax Code*

The Federal Tax Code contains the following loan eligibility requirements which are applicable (with certain exceptions), in whole or in part, to Contracts of Purchase (or portions of Contracts of Purchase) entered into with respect to properties acquired with amounts allocable to qualified veterans' mortgage bonds and/or to qualified mortgage bonds. The Offered Veterans G.O. Bonds are qualified veterans' mortgage bonds and not qualified mortgage bonds (as such terms are defined in APPENDIX E). The moneys which will be made available from the issuance of the Offered Veterans G.O. Bonds to finance Contracts of Purchase will be Qualified Veterans Mortgage Bond Proceeds (as defined in APPENDIX B).

The first general requirement of the Federal Tax Code which is applicable to qualified veterans' mortgage bonds is that the aggregate amount that may be issued must not exceed the volume limit based upon statutory formula. The Offered Veterans G.O. Bonds are in compliance with such requirement.

The Federal Tax Code requires that the effective interest rate on mortgage loans financed with the lendable proceeds of qualified mortgage bonds and qualified veterans' mortgage bonds may not exceed the yield on the issue by more than 1.125% (1.50% for pre-Ullman bonds, see "Yield Limitations and Rebate" in APPENDIX E) and that certain investment earnings on non-mortgage investments, calculated based upon the extent such investment earnings exceed the amount that would have been earned on such investments if the investments were invested at a yield equal to the yield on the issue, be rebated to the United States or to veterans. The Department has covenanted to comply with these requirements and has established procedures to determine the amount of excess earnings, if any, that must be rebated to the United States or to veterans. See APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – THE PROGRAM – Contracts of Purchase" for discussions of provisions of the Veterans Code which affect the Department's ability to establish and to change interest rates on Contracts of Purchase.

The Federal Tax Code states that an issuer will be treated as meeting the arbitrage restrictions on mortgage loans if it in good faith attempted to meet such requirement and any failure to meet such requirement was due to inadvertent error after taking all reasonable steps to comply with such requirement. See APPENDIX E – "CERTAIN FEDERAL TAX CODE REQUIREMENTS."

### *Opinion of Bond Counsel*

In the opinion of Bond Counsel (expected to be delivered in substantially the form set forth with respect to the Offered Veterans G.O. Bonds in APPENDIX G), under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, interest on the Offered Veterans G.O. Bonds (i) is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Code, and (ii) is not treated as a preference item for purposes of calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, *however*, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In addition, in the opinion of Bond Counsel, under existing statutes, interest on the Offered Veterans G.O. Bonds is exempt from State of California personal income taxes.

In rendering the foregoing opinions, Bond Counsel has assumed and continues to assume compliance by the State and the Department with and enforcement by the State and the Department of the documents authorizing the issuance of the Offered Veterans G.O. Bonds and the applicable Program Documents (as such term is defined in APPENDIX E). Bond Counsel has expressed and expresses no opinion as to the exclusion from gross income of interest on any Offered Veterans G.O. Bonds subsequent to any date on which action is taken pursuant to the documents authorizing the issuance of the Offered Veterans G.O. Bonds, for which action such documents require a legal opinion to the effect that taking such action will not adversely affect such exclusion, unless such firm delivers an opinion as of such date to such effect.

In rendering its opinions, Bond Counsel expresses no opinion regarding any other Federal or, except as stated below under "State Tax Matters," state tax consequences with respect to the Offered Veterans G.O. Bonds. Bond Counsel renders its opinions under existing statutes and court decisions as of the issue date, and assumes no obligation to update its opinions after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise. In rendering its opinions, Bond Counsel expresses no opinion on the effect of any action taken after the date of the opinion or not taken in reliance upon an opinion of other counsel on the exclusion from gross income for Federal income tax purposes of interest on the Offered Veterans G.O. Bonds, or under state and local tax law.

### *Certain Collateral Federal Tax Consequences*

The following is a brief discussion of certain Federal income tax matters with respect to the Offered Veterans G.O. Bonds under existing statutes. It does not purport to deal with all aspects of Federal taxation that may be relevant to a particular owner of an Offered Veterans G.O. Bond. Prospective investors, particularly those who may be subject to special rules, are advised to consult their own tax advisors regarding the Federal tax consequences of owning and disposing of the Offered Veterans G.O. Bonds.

As noted above, interest on the Offered Veterans G.O. Bonds is not a preference item in determining the tax liability of individuals, corporations, and other taxpayers subject to the alternative minimum tax imposed by Section 55 of the Internal Revenue Code of 1986, as amended. Interest on the Offered Veterans G.O. Bonds must also be taken into account in determining the tax liability of foreign corporations subject to the branch profits tax imposed by Section 884 of the Code.

Prospective Owners of Offered Veterans G.O. Bonds should be aware that the ownership of such obligations may result in collateral Federal income tax consequences to various categories of persons, such as corporations (including S corporations and certain foreign corporations), financial institutions, property and casualty insurance companies, individual recipients of Social Security or Railroad Retirement benefits, and individuals otherwise eligible for the earned income tax credit and to taxpayers deemed to have incurred or continued indebtedness to purchase or carry obligations the interest on which is not included in gross income for Federal income tax purposes.

Legislation affecting municipal bonds is frequently considered by the United States Congress. There can be no assurance that legislation enacted or proposed after the date of issuance of the Offered Veterans G.O. Bonds will not have an adverse effect on the tax-exempt status or market price of the Offered Veterans G.O. Bonds.

#### *Proposed Federal Tax Legislation*

Legislation has been introduced in the United States House of Representatives which, among other things, would repeal the 10-Year Rule (as defined in APPENDIX E) for principal prepayments and principal payments received after the date of enactment of the proposed legislation (the "House Bill"). A member of the Finance Committee of the United States Senate has introduced a bill identical to the House Bill (the "Senate Bill"). The House Bill, the Senate Bill, and another House bill recently introduced would also amend the purchase price limits established under the Federal Tax Code. There can be no assurance that such legislation will be enacted or that it will be enacted in its present form, or that other legislation regarding the 10-Year Rule or purchase price limits or other matters affecting the Federal Tax Code will not be introduced or enacted.

#### **State Tax Matters**

In the opinion of Bond Counsel to be rendered with respect to the Offered Veterans G.O. Bonds on the date of delivery thereof, interest on the Offered Veterans G.O. Bonds is exempt from personal income taxes of the State of California under State law in effect on the date of such opinion. A complete copy of the proposed form of opinion to be rendered with respect to the Offered Veterans G.O. Bonds is contained in APPENDIX G.

### **LEGAL OPINIONS**

A copy of the proposed form of the opinion of the Attorney General of the State of California as to the validity of the Offered Veterans G.O. Bonds is included in APPENDIX F. A copy of the proposed form of the opinion of Bond Counsel as to the validity of the Offered Veterans G.O. Bonds and treatment of interest thereon for Federal income tax purposes, is included in APPENDIX G.

The Attorney General undertakes no responsibility for the accuracy, completeness or fairness of this Official Statement.

Certain legal matters will be passed upon by Quateman & Zidell LLP, Disclosure Counsel to the State, and by Orrick, Herrington & Sutcliffe LLP, Special Counsel to the State regarding APPENDIX A. Certain legal matters will be passed upon for the Underwriters by their counsel, Kutak Rock LLP.

### **LITIGATION**

The Attorney General has advised that there is not now pending (with service of process on the Department completed) or known to the Attorney General of the State to be threatened any litigation seeking to restrain or enjoin the sale, issuance, execution or delivery of the Offered Veterans G.O. Bonds or in any manner affecting the validity of the Offered Veterans G.O. Bonds or any proceedings of the State taken with respect to the foregoing, except as follows.

As stated above, payment of the debt service on general obligation bonds of the State is contained in a continuing appropriation in the Bond Acts approved by the voters. In June 1998, a complaint was filed in Los Angeles County Superior Court in the case of *Howard Jarvis Taxpayers Association v. Kathleen Connell* challenging the authority of the State Controller to make payments in the absence of a State budget. The lawsuit did not specifically attack the validity of the Bond Acts or the continuing appropriations of funds to pay principal and interest on general obligation bonds. The Superior Court judge, however, issued a

preliminary injunction preventing the State Controller from making payments, including those made pursuant to continuing appropriations, while the State's annual budget act had not yet been enacted. As permitted by the State Constitution, the Legislature immediately enacted and the Governor signed an emergency appropriations bill that allowed continued payment of various state obligations, including debt service. This litigation is now pending before the Court of Appeal. See APPENDIX A - "THE STATE OF CALIFORNIA - LITIGATION" for more information about the status of this case.

The Attorney General and Bond Counsel will render an opinion that the conclusion of the Superior Court judge in the *Jarvis* case (which is now stayed pending appeal) questioning the validity of continuing appropriations, if and to the extent it would apply to the payment of debt service on the Offered Veterans G.O. Bonds, is without merit and that the California appellate courts would hold that the appropriations for debt service on the Offered Veterans G.O. Bonds contained in the Bond Acts are valid under the State Constitution and that the State Controller may make payments pursuant to such appropriations. While there can be no assurance as to the outcome of the litigation, the State believes that moneys will be available in due course on a timely basis to make all future payments of debt service on the Offered Veterans G.O. Bonds.

While at any given time, including the present, there are numerous civil actions pending against the State (including, but not limited to, those discussed in APPENDIX A), that could, if determined adversely to the State, affect the State's expenditures and, in some cases, its revenues, the Attorney General of the State is of the opinion that no pending civil actions, with service of process on the State completed, are likely to have a material adverse effect on the State's ability to pay principal of, premium, if any, and interest on the Offered Veterans G.O. Bonds when due. See APPENDIX A - "THE STATE OF CALIFORNIA - LITIGATION."

There may, from time to time, be litigation affecting the Department that does not directly relate to the Veterans G.O. Bonds, which may nonetheless relate to the 1943 Fund. See APPENDIX B - "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND - THE 1943 FUND - Debbs Litigation" for a discussion of certain litigation relating to the Department and the 1943 Fund.

## **UNDERWRITING**

The Offered Veterans G.O. Bonds (other than the Placed Bonds, which are being sold to an institutional investor) are being purchased by the Underwriters listed on the cover page. The Underwriters have jointly and severally agreed to purchase the Offered Veterans G.O. Bonds (other than the Placed Bonds) for a purchase price of the aggregate principal amount thereof plus accrued interest. In connection therewith the Department will pay a fee to the Underwriters of \$262,739.74. The initial public offering prices of the Offered Veterans G.O. Bonds (other than the Placed Bonds) may be changed from time to time by the Underwriters.

The purchase contract relating to the Offered Veterans G.O. Bonds (other than the Placed Bonds) provides that (i) the Underwriters will purchase all of the Offered Veterans G.O. Bonds (other than the Placed Bonds) if any of the Offered Veterans G.O. Bonds (other than the Placed Bonds) are purchased, and (ii) the obligation to make such purchase is subject to certain terms and conditions set forth in such purchase contract including, among others, the approval of certain legal matters by counsel.

In connection with the sale of the Placed Bonds to an institutional investor, the underwriting firms listed on the cover page will receive a placement fee of \$149,303.33.

## **FINANCIAL STATEMENTS**

Audited General Purpose Financial Statements of the State of California (the "Financial Statements") are available for the Fiscal Year ended June 30, 2000. Such Financial Statements have been filed with all of

the Nationally Recognized Municipal Securities Information Repositories as part of the Official Statement for State General Obligation Bonds sold previously during this year and are incorporated by reference into this Official Statement. The Financial Statements are also available through electronic means. See APPENDIX A – "THE STATE OF CALIFORNIA – FINANCIAL STATEMENTS" for further information on how to obtain or view the Financial Statements.

Certain unaudited financial information for the six months ended December 31, 2000 is included as EXHIBIT 1 to APPENDIX A. See APPENDIX A – EXHIBIT 1 – STATE CONTROLLER'S "STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS, December 2000."

### **INDEPENDENT AUDITORS**

Attached as EXHIBIT 1 to APPENDIX B are the Financial Statements for the Veterans Farm Home Building Fund of 1943 for the years ended June 30, 2000 and 1999. These statements have been audited by Deloitte & Touche LLP, independent auditors, as indicated in their report appearing in APPENDIX B.

### **RATINGS**

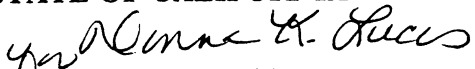
The Underwriters' obligation to purchase the Offered Veterans G.O. Bonds (other than the Placed Bonds) and the institutional investor's obligation to purchase the Placed Bonds are conditioned upon the Offered Veterans G.O. Bonds receiving ratings of "Aaa" by Moody's Investors Service, "AAA" by Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc., and "AAA" by Fitch. Such ratings will be based on the issuance of the Offered Veterans G.O. Bonds Municipal Bond Insurance Policy. An explanation of the significance and status of such credit ratings may be obtained from the rating agencies furnishing the same. There is no assurance that such ratings will continue for any given period of time or that they will not be revised or withdrawn entirely by any such rating agencies if, in their respective judgments, circumstances so warrant. On April 24, 2001, Standard & Poor's downgraded the State's general obligation debt (the "S&P GO Ratings") from "AA" to "A+" and continues to keep the S&P GO Rating on CreditWatch with negative implications. S&P at that same time gave the Veterans G.O. Bonds a rating of "AA-" with a stable outlook. On May 15, 2001, Moody's lowered the State's general obligation bond rating to Aa3 from Aa2 and the Moody's rating outlook remains negative. In April 2001, Fitch placed the State's "AA" rating on rating watch- negative. Further revisions or withdrawal of a credit rating could have an effect on the market price of the Offered Veterans G.O. Bonds. After the Offered Veterans G.O. Bonds are rated, the State Treasurer intends to provide appropriate periodic credit information to the rating agencies to promote maintenance of the ratings on the Offered Veterans G.O. Bonds.

### **ADDITIONAL INFORMATION**

The purpose of this Official Statement is to supply information to prospective buyers of the Offered Veterans G.O. Bonds. Public Resources Advisory Group has served as Financial Advisor in connection with the issuance of the Offered Veterans G.O. Bonds.

All financial and statistical data contained herein have been taken or constructed from State (including Department) records, except for information expressly attributed to other sources. The presentation of information, including tables of receipts from taxes and other revenues, is intended to show recent historic information and is not intended to indicate future or continuing trends in the financial position or other affairs of the State, including the Department. No representation is made that past experience, as it might be shown by such financial and other information, will necessarily continue or be repeated in the future. Any statements made in this Official Statement involving matters of opinion, projections or estimates, whether expressly stated or not, are set forth as such and not as representations of fact.

**STATE OF CALIFORNIA**

  
By: /s/ Philip Angelides  
Treasurer of the State of California

All financial and statistical data contained herein have been taken or constructed from State (including Department) records, except for information expressly attributed to other sources. The presentation of information, including tables of receipts from taxes and other revenues, is intended to show recent historic information and is not intended to indicate future or continuing trends in the financial position or other affairs of the State, including the Department. No representation is made that past experience, as it might be shown by such financial and other information, will necessarily continue or be repeated in the future. Any statements made in this Official Statement involving matters of opinion, projections or estimates, whether expressly stated or not, are set forth as such and not as representations of fact.

**STATE OF CALIFORNIA**

By: /s/ Philip Angelides  
Treasurer of the State of California



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APPENDIX A

THE STATE OF CALIFORNIA



*Honorable Philip Angelides  
Treasurer of the State of California*

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## OVERVIEW OF STATE GOVERNMENT

### Organization of State Government

The State Constitution provides for three separate branches of government: the legislative, the judicial and the executive. The Constitution guarantees the electorate the right to make basic decisions, including amending the Constitution and local government charters. In addition, the State voters may directly influence State government through the initiative, referendum and recall processes.

California's Legislature consists of a forty-member Senate and an eighty-member Assembly. Assembly members are elected for two-year terms, and Senators are elected for four-year terms. Assembly members are limited to three terms in office and Senators to two terms. The Legislature meets almost year round for a two-year session. The Legislature employs the Legislative Analyst, who provides reports on State finances, among other subjects. The Bureau of State Audits, headed by the State Auditor, an independent office since 1993, annually issues an auditor's report based on an examination of the General Purpose Financial Statements of the State Controller, in accordance with generally accepted accounting principles.

The Governor is the chief executive officer of the State and is elected for a four-year term. The Governor presents the annual budget and traditionally presents an annual package of bills constituting a legislative program. In addition to the Governor, State law provides for seven other statewide elected officials in the executive branch. The current elected statewide officials, their party affiliation and the dates on which they were first elected are as follows:

<u>Office</u>	<u>Name</u>	<u>Party Affiliation</u>	<u>First Elected</u>
Governor.....	Gray Davis	Democrat	1998
Lieutenant Governor.....	Cruz Bustamante	Democrat	1998
Treasurer.....	Philip Angelides	Democrat	1998
Attorney General .....	Bill Lockyer	Democrat	1998
Controller .....	Kathleen Connell	Democrat	1994
Secretary of State.....	Bill Jones	Republican	1994
Superintendent of Public Instruction.	Delaine Eastin	Democrat	1994
Insurance Commissioner .....	Harry Low	Democrat	appointed

The current term for each office expires in January 2003. Persons elected to statewide offices are limited to two terms in office.

The executive branch is principally administered through thirteen major agencies and departments: Business, Transportation and Housing Agency, Child Development and Education Agency, Environmental Protection Agency, Department of Finance, Department of Food and Agriculture, Health and Human Services Agency, Department of Industrial Relations, Resources Agency, State and Consumer Services Agency, Department of Veterans Affairs, Technology, Trade and Commerce Agency, and Youth and Adult Correctional Agency. In addition, some State programs are administered by boards and commissions, such as The Regents of the University of California, Public Utilities Commission, Franchise Tax Board and California

Transportation Commission, which have authority over certain functions of State government with the power to establish policy and promulgate regulations. The appointment of members of boards and commissions is usually shared by the Legislature and the Governor, and often includes ex officio members.

California has a comprehensive system of public higher education comprised of three sectors: the University of California, the California State University System and California Community Colleges. The University of California provides undergraduate, graduate and professional degrees to students. Approximately 44,556 degrees were awarded in the 1999-00 school year. About 167,000 full-time students were enrolled at the nine UC campuses and the Hastings College of Law in the 1999-00 school year. The California State University System, provides undergraduate and graduate degrees to students. Approximately 69,200 degrees were awarded in the 1999-00 school year. About 282,000 full-time students were enrolled at the 23 campuses in the 1999-00 school year. The third sector consists of 108 campuses operated by 72 community college districts which provide associate degrees and certificates. Approximately 90,000 associate degrees and certificates were awarded in the 1999-00 school year. About 1.6 million students were enrolled in California's community colleges in the fall of 2000.

### **Employee Relations**

In 2000-01, the State work force is estimated to be comprised of approximately 316,000 personnel years, of which approximately 108,000 personnel years represent employees of institutions of higher education. Of the remaining 208,000 personnel years, approximately 162,000 are subject to collective bargaining and approximately 46,000 are excluded from collective bargaining. The California State Employees' Association (CSEA) represents 9 of the 20 collective bargaining units, or approximately 52 percent of those employees subject to collective bargaining.

State law provides that State employees, defined as any civil service employee of the State and teachers under the jurisdiction of the Department of Education or the Superintendent of Public Instruction, and excluding certain other categories, have a right to form, join, and participate in the activities of employee organizations for the purpose of representation on all matters of employer-employee relations. The chosen employee organization has the right to represent its members, except that once an employee organization is recognized as the exclusive representative of a bargaining unit, only that organization may represent employees in that unit.

The scope of representation is limited to wages, hours, and other terms and conditions of employment. Representatives of the Governor are required to meet and confer in good faith and endeavor to reach agreement with the employee organization, and, if agreement is reached, to prepare a memorandum of understanding and present it to the Legislature for ratification. The Governor and the recognized employee organization are authorized to agree mutually on the appointment of a mediator for the purpose of settling any disputes between the parties, or either party could request the Public Employment Relations Board to appoint a mediator.

Since existing Memoranda of Understanding will expire on or before July 2, 2001, the State and all 21 collective bargaining units are now conducting negotiations for successor agreements. The State has not experienced a major work stoppage in more than 20 years.

## **RECENT DEVELOPMENTS REGARDING ENERGY**

### **Department of Water Resources Power Supply Program**

Shortages of electricity available within the service areas of California's three investor-owned utilities (the "Utilities") have resulted in the need to implement rotating electricity blackouts, affecting millions of Californians, on several occasions since the start of 2001. Following the first incidence of such blackouts in January 2001, the Governor proclaimed a state of emergency to exist in California under the California Emergency Services Act on the basis that the electricity available from California's Utilities was insufficient to prevent widespread and prolonged disruption of electric service in California. The Governor directed the State Department of Water Resources ("DWR") to enter into contracts and arrangements for the purchase and sale of electric power as necessary to assist in mitigating the effects of the emergency. The Governor's proclamation under the Emergency Services Act was followed by the enactment of legislation authorizing the DWR power supply program described below and related orders of the California Public Utilities Commission ("CPUC").

The DWR began selling electricity to 10 million retail electric customers in California in January 2001. The DWR purchases power from wholesale suppliers under long-term contracts and in short-term and spot market transactions. The DWR's power supply program is designed to cover the shortfall between the amount of electricity required by retail electric customers of the Utilities and the amount of electricity produced by the Utilities and purchased by the Utilities from others under existing contracts. Electricity purchased by the DWR is delivered to retail customers through the transmission and distribution systems of the Utilities, and payments from retail customers are collected for the DWR by the Utilities, segregated and held in trust for the DWR and remitted to the DWR. The DWR believes that its rates (described below) and servicing agreements which the DWR expects to enter into with the Utilities are being structured so that the Utilities will not have any claim, including in bankruptcy proceedings, to the revenue from retail customers.

The DWR's power supply program has been financed by unsecured loans from the General Fund (and certain other funds) of the State, plus retail customer payments received by DWR. As of May 21, 2001, the DWR had, since the start of the program on January 17, 2001, incurred power purchase obligations aggregating \$6.9 billion, of which \$6.2 billion was to be funded through General Fund advances and \$0.7 billion was to be paid from retail customer payments received by the DWR. As of May 21, 2001, \$4.8 billion of the General Fund advances had actually been disbursed. Additional loans from the General Fund are planned, but the amounts to be loaned have not been determined because the cash needs of the DWR power supply program depend, among other things, on future power purchase costs and the timing and amount of revenues from retail electric sales. Retail customer payments for electricity furnished by the DWR aggregate substantially less than the DWR's cost of purchasing that electricity



although recent rate increases, described below, will increase the DWR's receipts). As of May 21, 2001, the DWR had received retail customer payments totaling \$684 million. This shortfall will continue until prices paid for purchases of electricity fall to the point where revenues from rates charged to customers for electricity cover this expense (and related financing costs).

The DWR plans to sell revenue bonds beginning in September, 2001, to repay the then outstanding loans from the State (with accrued interest) and to provide working capital for the DWR power supply program. The bonds are to be issued under Division 27 (commencing with Section 80000) of the California Water Code, as amended effective August 14, 2001 (the "Power Act"), and a trust indenture that will provide that the revenue bonds are payable solely from payments from retail customers for electricity (and other funds held under the indenture). The revenue bonds will not be a liability of or backed by the State General Fund, and neither the faith and credit nor the taxing power of the State will be pledged to pay the revenue bonds. The State may make additional loans or other advances from the State General Fund to support the DWR power supply program subsequent to the issuance of the DWR revenue bonds. Alternative sources of additional funding for the power supply program (if needed) would be rate increases and additional revenue bonds or other obligations. The principal amount of revenue bonds that can be issued by the DWR under the Power Act may not exceed \$13.4 billion.

The Administration projects that the State has sufficient available resources to continue to make loans to support the DWR power supply program at least through the summer of 2001. At April 30, 2001, the General Fund had a cash balance of \$5.356 billion and the ability to borrow approximately \$9.555 billion more from internal State sources. See "State Finances—The General Fund—Inter-Fund Borrowings." Delays in issuing the DWR revenue bonds would in turn delay the DWR's planned loan repayments to the General Fund and may require additional loans from the General Fund. If State loans to the DWR affect available resources to pay for normal State operations, the State could issue short-term obligations to maintain adequate cash reserves. The State has issued short-term obligations in the past to meet its cash flow needs. See "State Indebtedness—Cash Flow Borrowings."

### **Retail Electric Rates**

Under the California Public Utilities Code, the retail rates of the Utilities are established by the CPUC. Rates for the electricity supplied by the DWR and the Utilities have been increased substantially in 2001. On March 27, 2001, the CPUC approved substantial electricity rate increases for end use customers in the service areas of the two largest Utilities. On May 15, 2001, the CPUC adopted orders setting a rate design to allocate the rate increase, with various rates applicable to different classes of customers and differing levels of usage. Under the Power Act, the DWR is to establish, revise and notify the CPUC of its revenue requirement at least annually, and more frequently as required, and the CPUC is to establish the retail rates to be charged to retail electric customers for power being sold by the DWR. The DWR notified the CPUC of its first revenue requirement on May 2, 2001, and CPUC action is expected soon to establish rates applicable solely to DWR electricity being delivered to retail customers.

Following regulatory changes in the late 1990's, the Utilities were required by State law

and CPUC orders to purchase the electricity needed in excess of their own generation and contractual resources at fluctuating short-term and spot wholesale prices, while the retail electric rates that they were permitted to charge their residential and small business customers were capped at specified levels. Beginning in mid-2000, power purchase costs exceeded retail charges, and the Utilities have reported substantial resulting losses. One result has been that the creditworthiness of the Utilities has deteriorated, adversely affecting their ability to purchase electricity. The two largest Utilities in the State, Pacific Gas and Electric Company ("PG&E") and Southern California Edison Company ("SCE"), reported publicly that they have, since January 2001, defaulted on some of their obligations.

On April 6, 2001, PG&E filed for voluntary protection under Chapter 11 of the federal Bankruptcy Code. The bankruptcy proceedings (the "PG&E Bankruptcy") are pending in U.S. Bankruptcy Court in San Francisco, California. During the PG&E Bankruptcy, PG&E's operations will continue under current management, while the Bankruptcy Court decides on the allocation of PG&E's available cash flow and assets among its various creditors. PG&E or other parties to the PG&E Bankruptcy may seek to have the Bankruptcy Court take actions which affect prices charged to retail customers for electricity or affect existing contracts for purchase or sale of electricity.

SCE has not sought protection of or been forced into bankruptcy, although this may change in the future. SCE has entered into a Memorandum of Understanding with the Governor (described further below) designed to strengthen its financial condition.

All three Utilities have applications pending before the CPUC seeking authorization to increase rates further to recover past losses and increase future revenues. See "Litigation" below for a discussion of related lawsuits. The amount and timing of further rate increases for electricity supplied by DWR and the Utilities may be affected by a number of factors, including rehearings and appeals of the applicable CPUC orders and the PG&E Bankruptcy.

### **Executive and Legislative Initiatives**

The Governor has stated that the State is focusing its efforts in four main areas: (1) increasing the energy supply through expedited plant construction and other sources of power generation; (2) decreasing energy demand and increasing efficiency; (3) expanding the use of long-term energy contracts rather than relying upon the spot market; and (4) maintaining the financial viability of California's public utilities. A number of power plant construction projects are underway in California and other Western states. As these new facilities become operational, the increased supply of power is expected reduce the risk of rotating blackouts and lower the cost of power in the wholesale market. In addition, the Governor has issued a series of Executive Orders to streamline the review process for new peaking power facilities; reduce administrative hurdles to accelerate power plant construction; promote development of renewable energy systems; increase the hours of operation of existing facilities; and provide for rebates and rate reductions to reward conservation efforts.

The Governor has conducted negotiations with the Utilities concerning the

above-mentioned efforts to maintain the financial viability of the Utilities. A memorandum of understanding ("MOU") has been reached with SCE (but not the other Utilities) as to such matters as financing undercollections of power purchase costs, the purchase of high-voltage transmission lines, and future power purchases and sales. The MOU with SCE is subject to the enactment of authorizing legislation and CPUC and Federal Energy Regulatory Commission approval, among other conditions. There can be no assurance that the MOU will be implemented as signed, or in any modified form.

Legislation was enacted in April, 2001, authorizing \$850 million in State expenditures for energy conservation efforts, including funds to weatherize homes of low-income residents, funds for rebates on energy-efficient appliances, incentives for businesses that cut consumption, and public information campaigns. Legislation was enacted in May, 2001, to create the California Consumer Power and Conservation Financing Authority, a new State agency that will be authorized to build, purchase and obtain by eminent domain electricity generation and transmission facilities and natural gas transmission facilities, to encourage energy conservation programs, and to issue revenue bonds to finance such programs. The State Legislature is considering various other bills dealing with energy matters.

### **Natural Gas Supplies**

California imports about 85 percent of its natural gas. Limited gas transmission pipeline capacity into California and a major pipeline break in New Mexico during the summer of 2000, coupled with increases in wholesale prices for natural gas in the United States, have resulted in substantial price increases that are being passed on to business and residential consumers. Pipeline expansion is planned but will not be complete for several years. Nationwide, relatively high prices for natural gas are likely to persist for several years. Shortages and pricing of natural gas supplies could adversely affect the economy, and particularly generation of electricity, much of which is fueled by natural gas.

### **Litigation**

A number of lawsuits have been filed concerning various aspects of the current energy situation. These include disputes over rates set by the CPUC; responsibility for electricity and natural gas purchases made by the Utilities and the California Independent System Operator; continuing contractual obligations of certain small power generators; and antitrust and fraud claims against various parties. See "Litigation" below for a discussion of certain of these lawsuits and further discussion of the PG&E Bankruptcy. Adverse rulings in certain of these matters may affect power costs borne by the DWR Power Supply Program described above.

## **Prospects**

With the peak electricity demand coming in the summer, additional rotating blackouts are expected in coming months of 2001. The extent of such disruptions cannot be predicted, and estimates from various sources vary widely. The State Department of Finance believes that the potential economic impacts of the electricity situation, including increased energy costs, are mitigated by the fact that California is a relatively energy-efficient state, ranking 50<sup>th</sup> among the 50 states in energy expenditures as a percent of gross product, according to US Department of Energy data for 1999. Nonetheless, the Department believes there is potential for economic disruption during the summer if blackouts are significant, and that longer term business investment and location decisions may be adversely affected.

While the State hopes that the measures described above, coupled with conservation, load management and improved energy efficiency, will mitigate future disruptions of the supply of electricity to the public and avoid them in the longer term, lower wholesale power prices and promote the financial recovery of the Utilities, the situation continues to be fluid and subject to many uncertainties. Unrestrained wholesale electricity prices expose the State to the need for additional, potentially significant rate increases on retail end use customers, resulting in a further drag on the State's economy. There can be no assurance that there will not be future disruptions in power supplies or related developments which could adversely affect the State's economy, and which could in turn affect State revenues, or the health and comfort of its citizens.

## **STATE INDEBTEDNESS**

### **General**

The State Treasurer is responsible for the sale of debt obligations of the State and its various authorities and agencies. The State has always paid the principal of and interest on its general obligation bonds, general obligation commercial paper notes, lease-purchase debt and short-term obligations, including revenue anticipation notes and revenue anticipation warrants, when due.

### **Capital Facilities Financing**

*General Obligation Bonds* - The State Constitution prohibits the creation of general obligation indebtedness of the State unless a bond law is approved by a majority of the electorate voting at a general election or a direct primary. General obligation bond acts provide that debt service on general obligation bonds shall be appropriated annually from the General Fund and all debt service on general obligation bonds is paid from the General Fund. Under the State Constitution, debt service on general obligation bonds is the second charge to the General Fund after the application of moneys in the General Fund to the support of the public school system and public institutions of higher education. See "State Finances – State Expenditures" below. Certain general obligation bond programs receive revenues from sources other than the sale of bonds or the investment of bond proceeds.

As of May 1, 2001, the State had outstanding \$22,890,018,000 aggregate principal amount of long-term general obligation bonds, and unused voter authorizations for the future issuance of \$11,979,499,000 of long-term general obligation bonds. This latter figure consists of \$4,697,034,000 of authorized commercial paper notes, described below (of which \$802,945,000 was outstanding), which had not yet been refunded by general obligation bonds, and \$7,282,465,000 of other authorized but unissued general obligation debt (including the most recent voter authorizations). See the table "Authorized and Outstanding General Obligation Bonds" under "State Debt Tables" below.

The General Obligation Bond Law permits the State to issue as variable rate indebtedness up to 20 percent of the aggregate amount of long-term general obligation bonds outstanding. As of May 1, 2001, there was no variable rate indebtedness outstanding; however, the State plans to issue such indebtedness in the future.

*Commercial Paper Program* - Pursuant to legislation enacted in 1995, voter approved general obligation indebtedness may be issued either as long-term bonds, or, for some but not all bond acts, as commercial paper notes. Commercial paper notes may be renewed or may be refunded by the issuance of long-term bonds. The State issues long-term general obligation bonds from time to time to retire its general obligation commercial paper notes. Pursuant to the terms of the bank credit agreement presently in effect supporting the general obligation commercial paper program, not more than \$1.5 billion of general obligation commercial paper notes may be outstanding at any time; this amount may be increased or decreased in the future. Commercial paper notes are deemed issued upon authorization by the respective Finance Committees, whether or not such notes are actually issued. As of May 1, 2001, the Finance Committees had authorized the issuance of up to \$4,697,034,000 of commercial paper notes; as of that date \$802,945,000 aggregate principal amount of general obligation commercial paper notes was outstanding.

*Lease-Purchase Debt* - In addition to general obligation bonds, the State builds and acquires capital facilities through the use of lease-purchase borrowing. Under these arrangements, the State Public Works Board, another State or local agency or a joint powers authority issues bonds to pay for the construction of facilities such as office buildings, university buildings or correctional institutions. These facilities are leased to a State agency or the University of California under a long-term lease which provides the source of payment of the debt service on the lease-purchase bonds. In some cases, there is not a separate bond issue, but a trustee directly creates certificates of participation in the State's lease obligation, which are marketed to investors. Under applicable court decisions, such lease arrangements do not constitute the creation of "indebtedness" within the meaning of the Constitutional provisions which require voter approval. For purposes of this section of the Official Statement and the tables under "State Debt Tables" below, "lease-purchase debt" or "lease-purchase financing" means principally bonds or certificates of participation for capital facilities where the rental payments providing the security are a direct or indirect charge against the General Fund and also includes revenue bonds for a State energy efficiency program secured by payments made by various State agencies under energy service contracts. Certain of the lease-purchase financings are supported by special funds rather than the General Fund (see "State Finances--Sources of Tax Revenue"). The tables do not include equipment leases or leases which were not sold, directly or

indirectly, to the public capital markets. The State had \$6,619,973,464 General Fund-supported lease-purchase debt outstanding at May 1, 2001. The State Public Works Board, which is authorized to sell lease revenue bonds, had \$2,308,544,000 authorized and unissued as of May 1, 2001.

*Non-Recourse Debt* - Certain State agencies and authorities issue revenue obligations for which the General Fund has no liability. Revenue bonds represent obligations payable from State revenue-producing enterprises and projects, which are not payable from the General Fund, and conduit obligations payable only from revenues paid by private users of facilities financed by the revenue bonds. The enterprises and projects include transportation projects, various public works projects, public and private educational facilities (including the California State University and University of California systems), housing, health facilities and pollution control facilities. There are 17 agencies and authorities authorized to issue revenue obligations (excluding lease-purchase debt). State agencies and authorities had \$28,674,361,510 aggregate principal amount of revenue bonds and notes which are non-recourse to the General Fund outstanding as of May 1, 2001, as further described in the table "State Agency Revenue Bonds and Conduit Financing" under "State Debt Tables" below.

Detailed tables showing the State's long-term debt appear in the section "State Debt Tables" below.

### **Cash Flow Borrowings**

As part of its cash management program, the State has regularly issued short-term obligations to meet cash flow needs. The following table shows the amount of revenue anticipation notes ("Notes") issued over the past five fiscal years. See "Prior Fiscal Years' Financial Results" and "Current State Budgets" below. The State did not issue any revenue anticipation notes during the 2000-01 fiscal year, the first such occurrence in eighteen years.

#### **State of California Revenue Anticipation Notes Issued Fiscal Years 1995-96 to 1999-2000**

<u>Fiscal Year</u>	<u>Type</u>	<u>Principal Amount (Billions)</u>	<u>Date of Issue</u>	<u>Maturity Date</u>
1995-1996	Notes	\$2.0	April 25, 1996	June 28, 1996
1996-1997	Notes Series A-C	3.0	August 6, 1996	June 30, 1997
1997-1998	Notes	3.0	September 9, 1997	June 30, 1998
1998-1999	Notes	1.7	October 1, 1998	June 30, 1999
1999-2000	Notes Series A-B	1.0	October 1, 1999	June 30, 2000

SOURCE: State of California, Office of the Treasurer.

## **STATE FINANCES**

### **The Budget Process**

The State's fiscal year begins on July 1 and ends on June 30. The State operates on a budget basis, using a modified accrual system of accounting, with revenues credited in the period in which they are measurable and available and expenditures debited in the period in which the corresponding liabilities are incurred.

The annual budget is proposed by the Governor by January 10 of each year for the next fiscal year (the "Governor's Budget"). Under State law, the annual proposed Governor's Budget cannot provide for projected expenditures in excess of projected revenues and balances available from prior fiscal years. Following the submission of the Governor's Budget, the Legislature takes up the proposal.

Under the State Constitution, money may be drawn from the Treasury only through an appropriation made by law. The primary source of the annual expenditure authorizations is the Budget Act as approved by the Legislature and signed by the Governor. The Budget Act must be approved by a two-thirds majority vote of each House of the Legislature. The Governor may reduce or eliminate specific line items in the Budget Act or any other appropriations bill without vetoing the entire bill. Such individual line-item vetoes are subject to override by a two-thirds majority vote of each House of the Legislature.

Appropriations also may be included in legislation other than the Budget Act. Bills containing appropriations (except for K-14 education) must be approved by a two-thirds majority vote in each House of the Legislature and be signed by the Governor. Bills containing K-14 education appropriations only require a simple majority vote. Continuing appropriations, available without regard to fiscal year, may also be provided by statute or the State Constitution. There is litigation pending concerning the validity of such continuing appropriations. See "Litigation" below.

Funds necessary to meet an appropriation need not be in the State Treasury at the time such appropriation is enacted; revenues may be appropriated in anticipation of their receipt.

### **The General Fund**

The moneys of the State are segregated into the General Fund and over 900 special funds, including bond, trust and pension funds. The General Fund consists of revenues received by the State Treasury and not required by law to be credited to any other fund, as well as earnings from the investment of State moneys not allocable to another fund. The General Fund is the principal operating fund for the majority of governmental activities and is the depository of most of the major revenue sources of the State. For additional financial data relating to the General Fund, see Exhibit 1 to this Appendix A. The General Fund may be expended as a consequence of appropriation measures enacted by the Legislature and approved by the Governor, as well as appropriations pursuant to various constitutional authorizations and initiative statutes.

## **The Special Fund for Economic Uncertainties**

The Special Fund for Economic Uncertainties ("SFEU") is funded with General Fund revenues and was established to protect the State from unforeseen revenue reductions and/or unanticipated expenditure increases. Amounts in the SFEU may be transferred by the State Controller to the General Fund as necessary to meet cash needs of the General Fund. The State Controller is required to return moneys so transferred without payment of interest as soon as there are sufficient moneys in the General Fund. At the end of each fiscal year, the Controller is required to transfer from the SFEU to the General Fund any amount necessary to eliminate any deficit in the General Fund.

The legislation creating the SFEU (Government Code §16418) contains a continuous appropriation from the General Fund authorizing the State Controller to transfer to the SFEU, as of the end of each fiscal year, the lesser of (i) the unencumbered balance in the General Fund and (ii) the difference between the State's "appropriations subject to limitation" for the fiscal year then ended and its "appropriations limit" as defined in Section 8 of Article XIII B of the State Constitution and established in the Budget Act for that fiscal year, as jointly estimated by the State's Legislative Analyst's Office and the Department of Finance. For a further description of Article XIII B, see "State Appropriations Limit" below. In certain circumstances, moneys in the SFEU may be used in connection with disaster relief.

For budgeting and accounting purposes, any appropriation made from the SFEU is deemed an appropriation from the General Fund. For year-end reporting purposes, the State Controller is required to add the balance in the SFEU to the balance in the General Fund so as to show the total moneys then available for General Fund purposes.

See the caption "Current State Budgets" below for information concerning the recent balances in the SFEU and projections of the balances for the current and upcoming fiscal years. As in any year, the Budget Act and related trailer bills are not the only pieces of legislation which appropriate funds. Other factors including re-estimates of revenues and expenditures, existing statutory requirements, and additional legislation introduced and passed by the Legislature may impact the reserve amount.

## **Inter-Fund Borrowings**

Inter-fund borrowing is used to meet temporary imbalances of receipts and disbursements in the General Fund. As of June 30, 2000, the General Fund had no outstanding loans from the SFEU, General Fund special accounts or other special funds.

In the event the General Fund is or will be exhausted, the State Controller is required to notify the Governor and the Pooled Money Investment Board (the "PMIB," consisting of the State Director of Finance, the State Treasurer and the State Controller). The Governor may then order the State Controller to direct the transfer of all or any part of the moneys not needed in special funds to the General Fund from such special funds, as determined by the PMIB. All money so transferred must be returned to the special fund from which it was transferred as soon as there is sufficient money in the General Fund to do so. Transfers cannot be made from a



special fund which will interfere with the objective for which such special fund was created, or from certain specific funds. When moneys transferred to the General Fund in any fiscal year from any special fund pursuant to the inter-fund borrowing mechanism exceed ten percent of the total additions as shown in the statement of operations of the preceding fiscal year as set forth in the Budgetary (Legal Basis) annual report of the State Controller, interest must be paid on such excess at a rate determined by the PMIB to be the current earning rate of the Pooled Money Investment Account.

Although any determination of whether a proposed borrowing from one of the special funds is permissible, any such determination must be made with regard to the facts and circumstances existing at the time of the proposed borrowing. The Attorney General of the State has identified certain criteria relevant to such a determination. For instance, amounts in the special funds eligible for inter-fund borrowings are legally available to be transferred to the General Fund if a reasonable estimate of expected General Fund revenues, based upon legislation already enacted, indicates that such transfers can be paid from the General Fund promptly if needed by the special funds or within a short period of time if not needed. In determining whether this requirement has been met, the Attorney General has stated that consideration may be given to the fact that General Fund revenues are projected to exceed expenditures entitled to a higher priority than payment of internal transfers, i.e., expenditures for the support of the public school system and public institutions of higher education and the payment of debt service on general obligation bonds of the State.

At the November 1998 election voters approved Proposition 2. This proposition requires the General Fund to repay loans made from certain transportation special accounts (such as the State Highway Account) at least once per fiscal year, or up to 30 days after adoption of the annual budget act. Since the General Fund may reborrow from the transportation accounts soon after the annual repayment is made, the proposition is not expected to have any adverse impact on the State's cash flow.

The following chart shows internal borrowable resources available for temporary loans to the General Fund on June 30 of each of the fiscal years 1997-98 through 1999-00 and estimates for 2000-01 and 2000-02:

Internal Borrowable Resources (Cash Basis) (Millions)					
	June 30				
	1998	1999	2000	2001*	2002*
Available Internal Borrowable Resources	\$6,866.8	\$8,720.0	\$9,427.2	\$11,406.2	\$10,371.91
Outstanding Loans					
From Special Fund for Economic Uncertainties	-0-	-0-	-0-	-0-	1,009.7
From Special Funds and Accounts	-0-	-0-	-0-	-0-	256.7
Total Outstanding Internal Loans	-0-	-0-	-0-	-0-	1,226.4
Unused Internal Borrowable Resources	<u>\$6,866.8</u>	<u>\$8,720.0</u>	<u>\$9,427.2</u>	<u>\$11,406.2</u>	<u>\$9,105.5</u>

\*Estimated

SOURCE: State of California, Office of the State Controller and State of California, Department of Finance. Information for the fiscal years ended June 30, 1998 through June 30, 2000 are actual figures. For the fiscal years ending June 30, 2001 and June 30, 2002, these figures were estimated as of May 14, 2001 by the Department of Finance.

### Investment of Funds

Moneys on deposit in the State's Centralized Treasury System are invested by the Treasurer in the Pooled Money Investment Account (the "PMIA"). As of April 30, 2001, the PMIA held approximately \$32.16 billion of State moneys, and \$17.50 billion of moneys invested for about 2,880 local governmental entities through the Local Agency Investment Fund ("LAIF"). The assets of the PMIA as of April 30, 2001, are shown in the following table:

#### Analysis of the Pooled Money Investment Account Portfolio\*

<u>Type of Security</u>	<u>Amount (Millions)</u>	<u>Percent of Total</u>
U.S. Treasury Bills and Notes	\$ 6,253	12.6%
Commercial Paper (corporate)	12,989	26.2
Certificates of Deposits	7,149	14.4
Corporate Bonds	2,432	4.9
Federal Agency Securities	12,645	25.5
Bankers Acceptances	--	--
Bank Notes	1,815	3.7
Loans Per Government Code	2,491	5.0
Time Deposits	4,726	9.5
Repurchases	--	--
Reverse Repurchases	(843)	(1.7)
	<u>\$48,660</u>	<u>100%</u>

\*Totals may not add due to rounding.

SOURCE: State of California, Office of the Treasurer.

The State's treasury operations are managed in compliance with the California Government Code and according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The PMIA operates with the oversight of the PMIB (consisting of the State Treasurer, the State Controller and the Director of Finance). The LAIF portion of the PMIA operates with the oversight of the Local Agency Investment Advisory Board (consisting of the State Treasurer and four other appointed members).

The Treasurer does not invest in leveraged products or inverse floating rate securities. The investment policy permits the use of reverse repurchase agreements subject to limits of no more than 10 percent of the PMIA. All reverse repurchase agreements are cash matched either to the maturity of the reinvestment or an adequately positive cash flow date which is approximate to the maturity of the reinvestment. The PMIA does not hold any investments in obligations of California investor-owned utilities.

The average life of the investment portfolio of the PMLA as of April 30, 2001 was 176 days.

### **Pension Trusts**

The pension contribution liability for the three principal retirement systems in which the State participates, the California Public Employee's Retirement System ("CalPERS"), the California State Teachers' Retirement System ("CalSTRS") and the University of California Retirement System ("UCRS"), is included in the financial statements of the State and described in Note 23 of Notes to the Financial Statements attached as Exhibit 1 and presented on Tables 29 and 30 in Note 23.

The three largest defined benefit retirement plans contained in the retirement systems and the State's share of the excess of the actuarial value of assets over the actuarial accrued liability of those plans at June 30, 1999 was reported to be as follows:

<u>Name of Plan</u>	<u>Excess of Actuarial Value of Assets Over Actuarial Accrued Liabilities</u>
Public Employees' Retirement Fund	\$12.143 billion
State Teachers' Retirement Fund	3.652 billion
University of California Retirement Plan	12.959 billion

Because the actuarial value of assets exceeded the actuarial accrued liability of the plans as shown in this table, the net pension obligation of the State as of June 30, 2000 was reported as zero for each of the three plans. Accordingly, at present, State contributions to the three plans consist only of current contributions calculated as a percentage of employee compensation. There is no assurance that this situation will continue because investment returns and other factors affecting the assets and liabilities of the plans will change over time, and at some point in the future, as in the past, the State may have to make payments to the retirement systems to cover actuarial accrued liabilities in excess of the actuarial value of assets.

Details concerning the three largest plans and information concerning the other plans contained in the retirement systems are included in Note 23 to the Audited General Purpose Financial Statements of the State of California for the year ended June 30, 2000, which are incorporated in this Official Statement. See "Financial Statements" below.

### **Welfare Reform**

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104-193, the "Law") fundamentally reformed the nation's welfare system. The Law includes provisions to: (i) convert Aid to Families with Dependent Children ("AFDC"), an entitlement program, to Temporary Assistance for Needy Families ("TANF"), a block grant program with lifetime time limits on TANF recipients, work requirements and other changes; (ii) deny certain federal welfare and public benefits to legal noncitizens (subsequent federal law has amended this provision), allow states to elect to deny additional benefits (including TANF) to legal

noncitizens, and generally deny almost all benefits to illegal immigrants; and (iii) make changes in the Food Stamp program, including to reduce maximum benefits and impose work requirements. The block grant formula under the Law is operative through federal fiscal year 2002.

Chapter 270, Statutes of 1997, embodies California's response to the federal welfare reforms. Effective January 1, 1998, California Work Opportunity and Responsibility to Kids ("CalWORKs") replaced the former AFDC and Greater Avenues to Independence ("GAIN") programs. Consistent with the federal law, CalWORKs contains time limits on the receipt of welfare aid, both lifetime as well as current period. The centerpiece of CalWORKs is the linkage of eligibility to work participation requirements.

Administration of the CalWORKs program is largely at the county level, and the counties receive financial incentives for success in this program. Beginning in 2000-01, county performance incentive earnings are subject to Budget Act appropriation. The 2000 Budget Act included \$250 million for incentives. It was anticipated that this entire amount, plus an additional appropriation in 2001-02, would be needed to pay county incentives earned prior to 2000-01. However, it is now estimated that only \$97 million is needed to pay the entire amount earned prior to 2000-01, leaving \$153 million for other purposes. Under the provisions of the 2000 Budget Act, this \$153 million would remain available for incentive payments. However, CalWORKs program funding needs have since increased primarily due to increased caseload as compared to previous estimates. As a result, the Administration is proposing to amend the 2000 Budget Act to specify that no funds appropriated in that Budget Act shall be for payment of CalWORKs county performance incentives. This would allow the current year performance incentive appropriation to be redirected to fund more critical program components. The proposed 2001-02 CalWORKs budget contains no funding for new incentive earnings.

Welfare caseloads have continued to decline with the implementation of the CalWORKs program. The 2001-02 CalWORKs caseload is projected to be 512,000, down from 528,000 cases in 2000-01 and a high of 921,000 cases in 1994-95. The longer-term impact of the new federal law and CalWORKs is being evaluated by the RAND Corporation, with a series of reports to be furnished and the final report due October 2001.

The 2000-01 CalWORKs budget reflects California's success in meeting the federally-mandated work participation requirements for federal fiscal years 1997, 1998, and 1999. Having met that goal, the federally-imposed maintenance-of-effort ("MOE") level for California was reduced from 80 percent of the federal fiscal year 1994 baseline expenditures for the former AFDC program (\$2.9 billion) to 75 percent (\$2.7 billion). It is expected that California will continue to meet the work participation goal in federal fiscal year 2000 and beyond. Recently the State successfully appealed a federal decision that California did not meet the 1997 work participation requirement. As a result, the State's MOE requirement is reduced on a one-time basis by an additional \$153.9 million (General Fund) for 2000-01, saving a corresponding amount for use in other programs.

In addition, California has received a TANF High Performance Bonus award of \$36.1 million in 2000-01. This one-time bonus is awarded to states for their successes in moving welfare recipients to work and sustaining their participation in the workforce.

In 2001-02, California will continue to meet, but not exceed, the federally-required \$2.7 billion combined State and county MOE requirement. The Governor's Budget proposes total CalWORKs-related expenditures of \$6.9 billion for 2001-02, including child care transfer amounts for the Department of Education and the general TANF Block Grant reserve.

### **Local Governments**

The primary units of local government in California are the counties, which range in population from 1,200 in Alpine County to nearly 9,900,000 in Los Angeles County. Counties are responsible for the provision of many basic services, including indigent health care, welfare, jails and public safety in unincorporated areas. There are also 475 incorporated cities, and thousands of special districts formed for education, utility and other services. The fiscal condition of local governments has been constrained since "Proposition 13" was enacted by California voters in 1978. Proposition 13 reduced and limited the future growth of property taxes and limited the ability of local governments to impose "special taxes" (those devoted to a specific purpose) without two-thirds voter approval. Counties, in particular, have had fewer options to raise revenues than many other local government entities, and have been required to maintain many services.

In the aftermath of Proposition 13, the State provided aid to local governments from the General Fund to make up some of the loss of property tax moneys, including taking over the principal responsibility for funding K-12 schools and community colleges. During the recession of the early 1990s, the Legislature eliminated most of the remaining components of post-Proposition 13 aid to local government entities other than K-14 education districts by requiring cities and counties to transfer some of their property tax revenues to school districts. However, the Legislature also provided additional funding sources (such as sales taxes) and reduced certain mandates for local services. See "Litigation" below for a discussion of a lawsuit brought by counties against the State challenging these actions.

The 2000 Budget Act and related legislation provide significant assistance to local governments, including \$212 million for one-time discretionary funding to local governments, \$539 million for various local public safety programs, including the Citizens' Option for Public Safety ("COPS") program to support local front-line law enforcement, sheriffs' departments for jail construction and operations, and district attorneys for prosecution, \$400 million for deferred maintenance of local streets and roads, \$115 million in assistance for housing, \$204 million for mental health and social services and \$85 million for environmental protection. In addition, legislation was enacted in 1999 to provide annual relief to cities based on 1997-98 costs of jail booking and processing fees paid to counties. For 2000-01, cities will receive approximately \$38 million in booking fees. For 2001-02 the Administration proposes to reduce funding for local law enforcement technology grants, but to provide \$242.6 million for the COPS and county juvenile justice crime prevention programs.

Historically, funding for the State's trial court system was divided between the State and the counties. In 1997, legislation consolidated the trial court funding at the State level in order to streamline the operation of the courts, provide a dedicated revenue source, and relieve fiscal pressure on the counties. Since then, the county general purpose contribution for court operations was reduced by \$386 million and cities are retaining \$62 million in fine and penalty revenue previously remitted to the State.

The entire statewide welfare system has been changed in response to the change in federal welfare law enacted in 1996 (see "Welfare Reform" above). Under the CalWORKs program, counties are given flexibility to develop their own plans, consistent with State law, to implement the program and to administer many of its elements, and their costs for administrative and supportive services are capped at the 1996-97 levels. Counties are also given financial incentives if, at the individual county level or statewide, the CalWORKs program produces savings associated with specified standards. Counties will still be required to provide "general assistance" aid to certain persons who cannot obtain welfare from other programs.

### **State Appropriations Limit**

The State is subject to an annual appropriations limit imposed by Article XIII B of the State Constitution (the "Appropriations Limit"). The Appropriations Limit does not restrict appropriations to pay debt service on voter-authorized bonds.

Article XIII B prohibits the State from spending "appropriations subject to limitation" in excess of the Appropriations Limit. "Appropriations subject to limitation," with respect to the State, are authorizations to spend "proceeds of taxes," which consist of tax revenues, and certain other funds, including proceeds from regulatory licenses, user charges or other fees to the extent that such proceeds exceed "the cost reasonably borne by that entity in providing the regulation, product or service," but "proceeds of taxes" exclude most State subventions to local governments, tax refunds and some benefit payments such as unemployment insurance. No limit is imposed on appropriations of funds which are not "proceeds of taxes," such as reasonable user charges or fees and certain other non-tax funds.

There are various types of appropriations excluded from the Appropriations Limit. For example, debt service costs of bonds existing or authorized by January 1, 1979, or subsequently authorized by the voters, appropriations required to comply with mandates of courts or the federal government, appropriations for qualified capital outlay projects, most State subventions to local governments, appropriations for tax refunds, appropriations of revenues derived from any increase in gasoline taxes and motor vehicle weight fees above January 1, 1990 levels, and appropriation of certain special taxes imposed by initiative (e.g., cigarette and tobacco taxes) are all excluded. The Appropriations Limit may also be exceeded in cases of emergency.

The State's Appropriations Limit in each year is based on the Limit for the prior year, adjusted annually for changes in State per capita personal income and changes in population, and adjusted, when applicable, for any transfer of financial responsibility of providing services to or from another unit of government or any transfer of the financial source for the provisions of services from tax proceeds to non tax proceeds. The measurement of change in population is a

blended average of statewide overall population growth, and change in attendance at local school and community college ("K-14") districts. The Appropriations Limit is tested over consecutive two-year periods. Any excess of the aggregate "proceeds of taxes" received over such two-year period above the combined Appropriations Limits for those two years, is divided equally between transfers to K-14 districts and refunds to taxpayers.

The Legislature has enacted legislation to implement Article XIII B which defines certain terms used in Article XIII B and sets forth the methods for determining the Appropriations Limit. California Government Code Section 7912 requires an estimate of the Appropriations Limit to be included in the Governor's Budget, and thereafter to be subject to the budget process and established in the Budget Act.

The following table shows the State's Appropriations Limit for the past three fiscal years, the current fiscal year and an estimate for 2001-02. Because of the extraordinary surge of revenues in 1999-00, the State has exceeded its Appropriations Limit in that year. However, until all pertinent fiscal information is available for the fiscal year 1999-00, the actual overage amount is still an estimate. As of the release of the 2001-02 May Revision, the Department of Finance projects the State's Appropriations Limit for 2000-01 will be \$2.093 billion under the State Appropriations Limit in fiscal year 2000-01 and \$9.769 billion under in fiscal year 2001-02. No refund of taxes will occur unless the State exceeds its Appropriations Limit in 2000-01.

**State Appropriations Limit  
(Millions)**

	<b>Fiscal Years</b>				
	1997-98	1998-99	1999-00	2000-01	2001-02
State Appropriations Limit	\$44,778	\$47,573	\$50,673	\$54,073	\$59,318*
Appropriations Subject to Limit	(40,743)	(43,777)	(51,648)*	(51,980)*	(49,549)*
Amount (Over)/Under Limit	\$ 4,035	\$ 3,796	\$ (975)*	\$ 2,093*	\$ 9,769*

\*Estimated/Projected

SOURCE: State of California, Department of Finance.

**Proposition 98**

On November 8, 1988, voters of the State approved Proposition 98, a combined initiative constitutional amendment and statute called the "Classroom Instructional Improvement and Accountability Act." Proposition 98 changed State funding of public education below the university level and the operation of the State Appropriations Limit, primarily by guaranteeing K-14 schools a minimum share of General Fund revenues. Proposition 98 (as modified by Proposition 111, enacted on June 5, 1990) guarantees K-14 schools the greater of (a) in general, a fixed percent of General Fund revenues ("Test 1"), (b) the amount appropriated to K-14 schools in the prior year adjusted for changes in the cost of living (measured as in Article XIII B by reference to State per capita personal income) and enrollment ("Test 2"), or (c) a third test, which replaces Test 2 with the percentage growth in per capita General Fund revenues from the

prior year plus one half of one percent is less than the percentage growth in State per capita personal income ("Test 3"). Under Test 3, schools receive the amount appropriated in the prior year adjusted for changes in enrollment and per capita General Fund revenues, plus an additional small adjustment factor. If Test 3 is used in any year, the difference between Test 3 and Test 2 becomes a "credit" to schools and the basis of payments in future years when per capita General Fund revenue growth exceeds per capita personal income growth. Proposition 98 implementing legislation adopted prior to the end of the 1988-89 fiscal year, determined the K-14 schools' funding guarantee under Test 1 to be 40.3 percent of the General Fund tax revenues, based on 1986-87 appropriations. However, that percent has been adjusted to approximately 35 percent to account for a subsequent redirection of local property taxes, since such redirection directly affects the share of General Fund revenues to schools.

Proposition 98 permits the Legislature by two-thirds vote of both houses, with the Governor's concurrence, to suspend the K-14 schools' minimum funding formula for a one-year period. Proposition 98 also contains provisions for the transfer of certain State tax revenues in excess of the Article XIII B limit to K-14 schools (see "State Finances--State Appropriations Limit" above).

During the recession in the early 1990s, General Fund revenues were less than originally projected for several years, so that the original Proposition 98 appropriations were higher than the minimum percentage provided in the law. The Legislature designated the "extra" Proposition 98 payments in one year as a "loan" from future years' Proposition 98 entitlements with the intention that "extra" payments would not be included in the Proposition 98 "base" for calculating future years' entitlements. As a result, per-pupil Proposition 98 funding remained approximately \$4,200 between fiscal years 1991-92 and 1993-94.

In 1992, a lawsuit titled *California Teachers' Association v. Gould* was filed, challenging the validity of these off-budget loans. A settlement of the lawsuit in 1996 requires both the State and K-14 schools to share in the repayment of \$1.76 billion prior years' emergency loans to schools. The State is repaying \$935 million by forgiveness, while schools will repay \$825 million. The State's share of the repayment is reflected as an appropriation above the current Proposition 98 base calculation. The schools' share of the repayment is reflected as part of the appropriations and counts toward satisfying the Proposition 98 guarantee or from "below" the current base. Repayments are spread over the eight-year period of 1994-95 through 2001-02 to mitigate any adverse fiscal impact.

Substantially increased General Fund revenues in the fiscal years 1994-95 through 2000-01 have resulted in significant increases in the level of Proposition 98 appropriations budgeted for those years. Because of the State's increasing revenues, per-pupil funding at the K-12 level has grown by more than 58 percent since 1991-92, to an estimated \$6,678 per pupil in 2000-01. Since the release of the Governor's Budget in January 2001, the projected level of revenue available to the State for fiscal year 2001-02 has declined precipitously. The revenue projection for 2001-02 indicates a decline of approximately \$4.6 billion. This drop in revenue has changed the calculation of the General Fund share of the minimum K-14 funding level from approximately \$30.9 billion to approximately \$28.0 billion. However, despite this decline in the calculated minimum guarantee, the Governor's May Revision for the 2001-02 Budget funds K-



14 education at more than \$4.5 billion above the minimum level and less than one percent under the level proposed in the Governor's Budget released in January 2001. Total funding for K-14, including prior year adjustments due to census changes, yields a funding level of more than \$46.5 billion or \$7,168 per pupil at the K-12 level—an increase of more than seven percent in just the last year. The Governor proposes new initiatives to lengthen the middle school year, advance technology in high schools, enhance school accountability, provide increased professional development in reading and mathematics, expand principal training, and provide incentives for intensive algebra instruction. See "Current State Budgets" for further discussion of education funding.

## **Sources of Tax Revenue**

The following is a summary of the State's major revenue sources. Further information on State revenues is contained under "Current State Budgets" and "State Finances -- Recent Tax Receipts" below.

### *Personal Income Tax*

The California personal income tax, which in 1999-00 contributed about 55 percent of General Fund revenues and transfers, is closely modeled after the federal income tax law. It is imposed on net taxable income (gross income less exclusions and deductions). The tax is progressive with rates ranging from 1.0 percent to 9.3 percent. Personal, dependent and other credits are allowed against the gross tax liability. In addition, taxpayers may be subject to an alternative minimum tax (AMT), which is much like the federal AMT.

Taxes on capital gains realizations, which have in part been linked to stock market performance, have become a larger component of personal income taxes in the last few years. For the 2000-01 fiscal year, capital gains realizations appear to be contributing nearly one-quarter of all General Fund revenue, a dramatic increase from their 5.6 percent share in 1995-96. See "Current State Budgets – Revenue and Expenditure Assumptions" below.

The personal income tax is adjusted annually by the change in the consumer price index to prevent taxpayers from being pushed into higher tax brackets without a real increase in income.

### *Sales Tax*

The sales tax is imposed upon retailers for the privilege of selling tangible personal property in California. Sales tax accounted for about 29 percent of General Fund revenue and transfers in 1999-00. Most retail sales and leases are subject to the tax. However, exemptions have been provided for certain essentials such as food for home consumption, prescription drugs, gas delivered through mains and electricity. Other exemptions provide relief for a variety of sales ranging from custom computer software to aircraft. Pursuant to federal law, out-of-state sales to Californians over the Internet are not taxed by the State at this time.

The breakdown of the basic 7.00 percent rate imposed on a statewide basis in 2001 is:

- 4.75 percent represents the State General Fund tax rate (expected to increase back to 5.00 percent effective January 1, 2002, due to the sales tax trigger described below).
- 2.00 percent is dedicated to cities and counties.
- 0.25 percent is dedicated to county transit systems.

Legislation in July 1991 raised the sales tax rate by 1.25 percent to its current level. Of this amount, 0.25 percent was added to the General Fund tax rate, and the balance was dedicated to cities and counties. One-half percent was a permanent addition to counties, but with the money earmarked to trust funds to pay for health and welfare programs whose administration was transferred to counties. Another 0.5 percent of the State General Fund tax rate that was scheduled to terminate after June 30, 1993, was extended until December 31, 1993, and allocated to local agencies for public safety programs. Voters in a special election on November 2, 1993, approved a constitutional amendment to permanently extend this 0.5 percent sales tax for local public safety programs.

Pursuant to law, 0.25 percent of a basic 5.00 percent State tax rate may be terminated upon certification by the Director of Finance by November 1 in any year that the balance in the budget reserve for two consecutive years will exceed 4 percent of General Fund revenues. The 0.25 percent rate will be reinstated if the Director of Finance subsequently determines that the reserve will not exceed 4 percent of General Fund revenues. Pursuant to this law, a 0.25 percent cut in the State sales tax occurred on January 1, 2001. The Administration projects that this rate will be reinstated as of January 1, 2002, based on an estimated budget reserve at June 30, 2002 of less than 4 percent of General Fund revenues. See "Current State Budgets—Fiscal Year 2001-02 Budget" below.

#### *Bank and Corporation Tax*

Bank and corporation tax revenues, which comprised about 9 percent of General Fund revenues and transfers in 1999-00, are derived from the following taxes:

1. The franchise tax and the corporate income tax are levied at an 8.84 percent rate on profits. The former is imposed on corporations for the privilege of doing business in California, while the latter is imposed on corporations that derive income from California sources but are not sufficiently present to be classified as doing business in the State.
2. Banks and other financial corporations are subject to the franchise tax plus an additional tax at the rate of 2 percent on their net income. This additional tax is in lieu of personal property taxes and business license taxes.
3. The alternative minimum tax (AMT) is similar to that in federal law. In general, the AMT is based on a higher level of net income computed by adding back certain tax preferences. This tax is imposed at a rate of 6.65 percent.

4. A minimum franchise tax of up to \$800 imposed on corporations subject to the franchise tax but not on those subject to the corporate income tax. New corporations are exempted from the minimum franchise tax for the first two years of incorporation.

5. Sub-Chapter S corporations are taxed at 1.5 percent of profits.

### *Insurance Tax*

The majority of insurance written in California is subject to a 2.35 percent gross premium tax. For insurers, this premium tax takes the place of all other state and local taxes except those on real property and motor vehicles. Exceptions to the 2.35 percent rate are certain pension and profit-sharing plans which are taxed at the lesser rate of 0.5 percent, surplus lines and nonadmitted insurance at 3 percent and ocean marine insurers at 5 percent of underwriting profits. Insurance taxes comprised approximately 2 percent of General Fund revenues and transfers in 1999-00.

### *Other Taxes*

Other General Fund major taxes and licenses include: Estate, Inheritance and Gift Taxes, Cigarette Taxes, Alcoholic Beverage Taxes, Horse Racing Revenues and trailer coach license fees. These other sources totaled approximately 2.0 percent of General Fund revenues and transfers in fiscal year 1999-00.

### *Special Fund Revenues*

The California Constitution and statutes specify the uses of certain revenue. Such receipts are accounted for in various special funds. In general, special fund revenues comprise three categories of income:

1. Receipts from tax levies which are allocated to specified functions, such as motor vehicle taxes and fees and certain taxes on tobacco products.
2. Charges for special services to specific functions, including such items as business and professional license fees.
3. Rental royalties and other receipts designated for particular purposes (e.g., oil and gas royalties).

Motor vehicle related taxes and fees accounted for about 53 percent of all special fund revenues and transfers in 1999-00. Principal sources of this income are motor vehicle fuel taxes, registration and weight fees and vehicle license fees. During fiscal year 1999-00, \$8.3 billion was derived from the ownership or operation of motor vehicles. This was 3.7 percent below the 1998-99 level, due to tax reductions enacted for vehicle license fees. About \$4.4 billion of this revenue was returned to local governments. The remainder was available for various State programs related to transportation and services to vehicle owners. These amounts (as well as

those shown below in the table "Comparative Yield of State Taxes--All Funds") include the additional fees and taxes derived from the passage of Proposition 111 in June 1990.

#### *Vehicle License Fee*

Vehicle license fees, over and above the costs of collection and refunds authorized by law, are constitutionally defined local revenues. Chapter 322, Statutes of 1998 ("Chapter 322"), established a vehicle license fee offset program, scheduled to be implemented in successive stages if General Fund revenues met certain targets. Pursuant to Chapter 322, vehicle license fees were reduced (offset) by 25 percent beginning January 1, 1999. Later legislation increased the offset to 35 percent for 2000 and the first half of calendar year 2001. Beginning July 1, 2001, the offset will be permanently increased to 67.5 percent. These offset levels are expected to reduce vehicle license fee revenues by \$1.833 billion in fiscal year 2000-01, \$3.653 billion in 2001-02, and \$3.855 billion in 2002-03. The amount will be adjusted thereafter as vehicle sales activity changes.

Under Chapter 322, a continuous appropriation from the General Fund backfills the vehicle license fee revenue that local governments would otherwise lose due to the fee reductions. If in any year the Legislature fails to appropriate enough funds to fully backfill the then-applicable vehicle license fee offset, the percentage offset will be reduced to assure that local governments are not disadvantaged.

In response to revenue growth, the Legislature provided an additional 32.5 percent vehicle license fee reduction for the period January 1, 2001, through June 30, 2001. This additional reduction is returned to taxpayers in the form of a rebate. The Legislature appropriated \$2.052 billion in 2000-01 to fund taxpayer rebates in 2000-01 and a portion of the 67.5 percent offset in 2001-02. Therefore, total tax relief from the vehicle license fee offset and rebates is \$3.9 billion General Fund in fiscal year 2000-01 and \$2.4 billion General Fund in 2001-02.

#### *Taxes on Tobacco Products*

On November 8, 1988, voters approved Proposition 99, which imposed, as of January 1, 1989, an additional 25 cents per pack excise tax on cigarettes, and a new, equivalent excise tax on other tobacco products. The initiative requires that funds from this tax be allocated to anti-tobacco education and research and indigent health services, and environmental and recreation programs.

Proposition 10, approved in 1998, increased the excise tax imposed on distributors selling cigarettes in California to 87 cents per pack effective January 1, 1999. At the same time, this proposition imposed a new excise tax on cigars, chewing tobacco, pipe tobacco, and snuff at a rate equivalent to the tax increase on cigarettes of 50 cents per pack. In addition, the higher excise tax on cigarettes automatically triggered an additional increase in the tax on other tobacco products effective July 1, 1999, with the proceeds going to the Cigarette and Tobacco Products Surtax Fund. Thus, this Proposition increased the total excise tax on other tobacco products by

an amount equivalent to an increase in the cigarette tax of one dollar per pack. There is litigation pending challenging the enactment of these new taxes. See "Litigation."

The State excise tax on cigarettes of 87 cents per pack and other tobacco product taxes are earmarked as follows:

- Fifty cents of the per-pack tax on cigarettes, and the equivalent rate levied on non-cigarette tobacco products, go to the California Children and Families First Trust Fund and are allocated primarily for early childhood development programs.
- Twenty-five cents of the per-pack tax on cigarettes, and the equivalent rates levied on non-cigarette tobacco products are allocated to the Cigarette and Tobacco Products Surtax Fund. These funds are appropriated for anti-tobacco education and research, indigent health services, and environmental and recreation programs. This portion of the excise tax was imposed on January 1, 1989, as voters approved Proposition 99 of 1988.
- Ten cents of the per-pack tax is allocated to the State's General Fund.
- The remaining two cents of the per-pack tax is deposited into the Breast Cancer Fund. Legislation enacted in 1993 added the additional per pack excise tax for the purpose of funding breast cancer research.

### **Tobacco Litigation**

In 1998, the State signed a settlement agreement with the four major cigarette manufacturers. The State agreed to drop its lawsuit and not to sue in the future for monetary damages. Tobacco manufacturers agreed to billions of dollars in payments and restrictions in marketing activities. Under the settlement, the companies agreed to pay California governments approximately \$1 billion (subject to adjustments) over a period of 25 years. Beyond 2025, payments of approximately \$1 billion per year will continue in perpetuity. Under a separate Memorandum of Understanding, half of the money will be paid to the State and half to local governments (all counties and the cities of San Diego, Los Angeles, San Francisco and San Jose). During fiscal year 2000-01, the General Fund received \$383 million in settlement payments. The May Revision of the Governor's Budget forecasts payments to the State totaling \$475 billion in 2001-02.

The specific amount to be received by the State and local governments is subject to adjustment. Details in the settlement allow reduction of the companies' payments for decreases in cigarette sales and certain types of federal legislation. Settlement payments can increase due to inflation or increases in cigarette sales. The "second annual" payment, received in April 2001, was 7.2 percent lower than the base settlement amount due to reduced sales. Future payment estimates have been reduced by a similar percentage. If any of the companies goes into bankruptcy, the State could seek to terminate the agreement with respect to those companies filing bankruptcy actions thereby reinstating all claims against those companies. The State may then pursue those claims in the bankruptcy litigation, or as otherwise provided by law. Also,

several parties have brought a lawsuit challenging the settlement and seeking damages; see "Litigation" below.

### Recent Tax Receipts

The following table shows the trend of major General Fund and total taxes per capita and per \$100 of personal income for the past four years and the current fiscal year.

<b>Trend of State Taxes</b>				
<b><u>Fiscal Year</u></b>	<b><u>Taxes per Capita(a)</u></b>		<b><u>Taxes per \$100 of Personal Income</u></b>	
	<b><u>General Fund</u></b>	<b><u>Total</u></b>	<b><u>General Fund</u></b>	<b><u>Total</u></b>
1997-98 .....	\$1,632.83	\$1,965.33	\$6.25	\$7.52
1998-99 .....	1,743.16	2,088.35	6.30	7.54
1999-00(b) .....	2,063.62	2,408.38	7.06	8.24
2000-01(c) .....	2,201.71	2,563.02	6.87	7.99
2001-02(c) .....	2,073.81	2,375.73	6.46	7.40

(a) Data reflect population figures based on the 2000 Census and incorporated estimated census undercount.

(b) Preliminary.

(c) Estimated.

SOURCE: State of California, Department of Finance.

The following table gives the actual and estimated growth in revenues by major source for the last four years and the current fiscal year.

**COMPARATIVE YIELD OF STATE TAXES—ALL FUNDS**  
**1997-98 THROUGH 2001-02**  
**(Modified Accrual Basis)**  
**(Thousands of Dollars)**

<b>Year Ending June 30</b>	<b>Sales and Use(a)</b>	<b>Personal Income</b>	<b>Bank and Corporation (b)</b>	<b>Tobacco(c)</b>	<b>Inheritance, Estate and Gift</b>	<b>Insurance</b>	<b>Alcoholic Beverages</b>	<b>Horse Racing</b>	<b>Motor Vehicle Fuel(d)</b>	<b>Motor Vehicle Fees(e)</b>
1998	21,331,691	27,927,940	5,836,881	44,297	780,197	1,221,285	270,947	81,930	2,853,846	5,660,574
1999	22,890,693	30,894,865	5,724,237	5,512	890,490	1,253,972	273,112	61,185	3,025,226	5,610,374
2000	25,525,788	39,578,237	6,638,898	6,651	928,146	1,299,777	282,166	44,130	3,069,694	5,263,245
2001(f)	24,581,823(g)	44,760,000	6,583,000	9,400	1,115,000	1,470,000	288,000	42,078	3,141,973	5,231,341
2002(f)	24,611,378(g)	42,143,500	5,873,300	1,139,480	1,022,000	1,452,000	291,000	42,078	3,178,026	3,768,540

- (a) For fiscal years 1997-98 through 1999-00, numbers include local tax revenue from the 0.5 percent rate increase that the voters passed in November 1993, for local public safety services. For fiscal years 2000-01 and 2001-02 the estimates do not include this revenue. The 0.5% rate is equivalent to about \$2 billion.
- (b) Includes the corporation income tax.
- (c) Proposition 10 (November 1998) increased the cigarette tax to \$0.87 per pack and added the equivalent of \$1.00 tax to other tobacco products.
- (d) Motor vehicle fuel tax (gasoline), use fuel tax (diesel and other fuels), and jet fuel.
- (e) Registration and weight fees, motor vehicle license fees and other fees. Due to the offset program, 1998-99 vehicle license fee values reflect a 25 percent reduction for 1999. The values reflect a 35 percent reduction for 2000 and the first half of 2001. Starting July 1, 2001, values reflect a 67.5 percent reduction.
- (f) Estimated. See "Current State Budgets."
- (g) As stated in footnote (a), the figures for fiscal years 2000-01 through 2001-02 do not include voter approved local revenue.

SOURCE: Fiscal years 1997-98 through 1999-2000: State of California, Office of the State Controller.  
Fiscal years 2000-01 and 2001-02: State of California, Department of Finance.

## State Expenditures

The following table summarizes the major categories of State expenditures, including both General Fund and special fund programs.

<b>GOVERNMENTAL COST FUNDS</b> <b>(Budgetary Basis)</b> <b>Schedule of Expenditures by Function and Character</b> <b>Fiscal Years 1995-96 to 1999-00</b> <b>(Thousands)</b>					
	<u>1995-96</u>	<u>1996-97</u>	<u>1997-98</u>	<u>1998-99</u>	<u>1999-00</u>
Function					
Legislative, Judicial, Executive					
Legislative.....	\$ 187,768	\$ 196,642	\$ 209,690	\$ 219,814	\$ 323,323
Judicial .....	704,112	716,712	766,932	1,346,131	1,372,681
Executive .....	691,264	961,025	919,606	958,189	1,241,219
State and Consumer Services	749,368	734,238	771,444	829,745	856,096
Business, Transportation and Housing					
Business and Housing.....	243,185	115,089	136,558	136,893	156,499
Transportation.....	3,334,648	3,650,506	3,924,428	4,462,905	5,549,520
Trade and Commerce.....	51,280	63,789	62,235	130,796	488,489
Resources.....	1,179,481	1,310,074	1,323,860	1,695,323	1,858,844
Environmental Protection .....	505,206	507,156	605,584	600,060	689,678
Health and Welfare .....	17,275,117	17,987,919	18,059,611	19,616,132	21,806,291
Correctional Programs .....	3,638,672	3,606,674	3,901,296	4,181,474	4,412,542
Education					
Education—K through 12.....	16,773,927	19,916,015	21,574,341	22,783,975	26,356,838
Higher Education .....	5,844,282	6,599,573	7,022,658	7,838,117	8,553,343
General Government					
General Administration.....	672,935	743,024	764,615	859,703	982,923
Debt Service.....	2,153,682	2,048,475	1,979,211	1,988,176	2,072,960
Tax Relief .....	474,179	454,509	453,030	450,213	1,840,129
Shared Revenues.....	3,346,240	3,690,512	3,892,036	4,151,197	3,677,687
Other Statewide Expenditures.....	202,158	133,309	1,373,823	891,070	580,307
Expenditure Adjustment for					
Encumbrances.....	(7,691)	(190,609)	(162,630)	(461,310)	(628,506)
Credits for Overhead Services by General					
Fund .....	(130,016)	(147,019)	(125,678)	(144,041)	(170,594)
Statewide Indirect Cost Recoveries .....	(48,730)	(23,307)	(48,963)	(32,791)	(37,423)
Total.....	<u>\$57,841,067</u>	<u>\$63,074,306</u>	<u>\$67,403,687</u>	<u>\$72,501,771</u>	<u>\$81,891,846</u>
Character					
State Operations.....	\$17,341,247	\$17,924,850	\$20,199,031	21,092,849	22,864,874
Local Assistance .....	39,973,320	44,686,447	46,666,925	50,734,442	58,369,828
Capital Outlay.....	526,500	463,009	537,731	674,480	657,144
Total.....	<u>\$57,841,067</u>	<u>\$63,074,306</u>	<u>\$67,403,687</u>	<u>\$72,501,771</u>	<u>\$81,891,846</u>

SOURCE: State of California, Office of the State Controller.



## PRIOR FISCAL YEARS' FINANCIAL RESULTS

Following a severe recession beginning in 1990, the State's financial condition improved markedly during the fiscal years starting in 1995-96, due to a combination of better than expected revenues, slowdown in growth of social welfare programs, and continued spending restraint based on actions taken in earlier years. The State's cash position also improved, and no external deficit borrowing occurred over the end of the last five fiscal years.

The economy grew strongly during the fiscal years beginning in 1995-96, and as a result, the General Fund took in substantially greater tax revenues (around \$2.2 billion in 1995-96, \$1.6 billion in 1996-97, \$2.4 billion in 1997-98, \$1.7 billion in 1998-99, and \$8.2 billion in 1999-2000) than were initially planned when the budgets were enacted. These additional funds were largely directed to school spending as mandated by Proposition 98, to make up shortfalls from reduced federal health and welfare aid in 1995-96 and 1996-97 and to fund new program initiatives, including education spending above Proposition 98 minimums, tax reductions, aid to local governments and infrastructure expenditures.

The combination of resurging exports, a strong stock market, and a rapidly-growing economy in 1999 and early 2000 resulted in unprecedented growth in General Fund revenues during fiscal year 1999-2000. The latest estimates from the Department of Finance indicate revenues of about \$71.9 billion, an increase of over 20 percent over final 1998-99 revenues and \$8.9 billion higher than projected for the 1999 Budget Act. The latest estimates indicate expenditures of \$66.5 billion in 1999-2000, a \$2.8 billion increase over the 1999 Budget Act, but the result still left a record balance in the Special Fund for Economic Uncertainties at June 30, 2000 of over \$8.7 billion.

## CURRENT STATE BUDGETS

*The discussion below of the fiscal year 2000-01 and 2001-02 budgets and the table under "Summary of State Revenues and Expenditures" are based on estimates and projections of revenues and expenditures for the current and upcoming fiscal years and must not be construed as statements of fact. These estimates and projections are based upon various assumptions as updated in the 2000 Budget Act and 2001-02 Governor's Budget and May Revision, which may be affected by numerous factors, including future economic conditions in the State and the nation, and there can be no assurance that the estimates will be achieved. See "Current State Budgets—Revenue and Expenditure Assumptions" below.*

### Fiscal Year 2000-01 Budget

*2000 Budget Act.* The 2000 Budget Act, signed by the Governor on June 30, 2000, was enacted on time for the second consecutive year. The spending plan assumed General Fund revenues and transfers of \$73.9 billion, a 3.8 percent increase over 1999-00 estimates. The 2000 Budget Act appropriated \$78.8 billion from the General Fund, a 17.3 percent increase over 1999-00 and reflected the use of \$5.5 billion from the Special Fund for Economic Uncertainties available from surpluses in the prior year. In order not to place undue pressure on future budget

years, about \$7.0 billion of the increased spending in 2000-01 was for one-time expenditures and investments.

At the time the 2000 Budget Act was signed, the Department of Finance estimated the June 30, 2001 SFEU balance to be \$1.781 billion. In addition, the Governor held back \$500 million as a set-aside for litigation costs. The Governor vetoed just over \$1 billion in General Fund and Special Fund appropriations from the Budget approved by the Legislature, in order to achieve the budget reserve. Because of the State's strong cash position, the Administration announced that it would not undertake a revenue anticipation note borrowing in 2000-01.

The 2000 Budget Act also included Special Fund expenditures of \$15.6 billion and Bond Fund expenditures of \$5.0 billion. Special Fund revenues are estimated at \$16.5 billion.

Some of the major features of the 2000 Budget Act were the following:

1. Proposition 98 funding for K-12 schools was increased by \$3.0 billion in General Fund moneys over revised 1999-2000 levels, \$1.4 billion higher than the minimum Proposition 98 guarantee. Per pupil spending is estimated at \$6,701 per ADA, an 11 percent increase from the 1999 Budget Act. Of the 2000-01 funds, over \$1.8 billion is allowed for discretionary spending by school districts. Major new programs included money for high school scholarship to high-achieving students, English language and literacy, improving teacher quality, funding teacher bonuses and salaries for beginning teachers, increasing investments in technology and funding professional development institutes. The 2000 Budget Act also includes an income tax credit to compensate credentialed teachers for the purchase of classroom supplies and a \$350 million repayment of prior years' loans to schools, as part of the settlement of the *CTA v. Gould* lawsuit. See also "State Finances – Proposition 98" above.

2. Funding for higher education increased substantially above the revised 1999-2000 level. General Fund support was increased by \$486 million (17.9 percent) for the University of California and \$279 million (12.7 percent) for the California State University system. In addition, Community Colleges funding increased by \$497 million (9.0 percent). Undergraduate fees at UC and CSU and the per-unit charge at Community Colleges will be unchanged. The Budget Act anticipates enrollment increases in all sectors, and an expansion of financial aid.

3. Increased funding of \$2.7 billion General Fund for health and human services.

4. Significant moneys were devoted for capital outlay. A total of \$2.0 billion of General Fund money was appropriated for transportation improvements, supplementing gasoline tax revenues normally used for that purpose. This was part of a \$6.9 billion Transportation Congestion Relief Program to be implemented over six years. In addition, the Budget Act included \$570 million from the General Fund in new funding for housing programs.

5. A total of about \$1.5 billion of tax relief was enacted as part of the budget process. The vehicle license fee reduction, started in 1998, was accelerated to the final 67.5 percent level for calendar year 2001, two years ahead of schedule. The acceleration will cost the

General Fund about \$887 million in fiscal year 2000-01 and \$1.426 billion in fiscal year 2001-02. A one-time Senior Citizens Homeowner and Renters Tax Assistance program will cost about \$154 million. A personal income tax credit for teachers will cost \$218 million and a refundable credit for child care expenses will cost \$195 million. Several other targeted tax cuts, primarily for businesses, were also approved, at a cost of \$89 million in 2000-01.

6. A one-time appropriation of \$200 million, to be split between cities and counties, was made to offset property tax shifts during the early 1990s. Additionally, \$121 million was appropriated to the COPS program for support of local law enforcement, and \$75 million in one-time funding was provided for local law enforcement agencies to purchase high technology equipment.

*Subsequent Developments.* The Legislature passed a number of bills with fiscal impacts on the General Fund in 2000-01, which were not included in the 2000-01 Budget, prior to the end of its session on August 31, 2000. Among these were bills to expedite the licensing of new power plants (\$57.5 million), to establish a juvenile crime prevention program (\$121 million) and to augment the Senior Citizens Property Tax Assistance Program (\$100 million). Another bill would enhance retirement benefits for both active and retired teachers. Excess assets and normal cost surplus in the program would fund the costs of enhanced benefits and also provide a \$100 million General Fund savings for 2000-01 from reduced contributions to the State Teachers Retirement System.

Based on results through the first quarter of fiscal year 2000-01, the Department of Finance estimated that revenues were sufficiently strong to make it likely that the State would end the fiscal year at June 30, 2001 with a balance in the budget reserve greater than 4 percent of General Fund revenues. Based on this estimate, since the reserve for the year ended June 30, 2000, was also above 4 percent of General Fund revenues, the Governor announced on October 25, 2000, that, pursuant to provisions in the law enacted in 1991 when the State sales tax rate was last raised, the State sales tax rate would be reduced by 0.25 percent for a period of at least one calendar year, effective January 1, 2001. This reduction will result in approximately \$553 million less General Fund revenue in the last half of fiscal year 2000-01 and approximately \$600 million less in the first half of fiscal year 2001-02. If the General Fund reserve falls below 4 percent of General Fund revenue in the future, the sales tax rate could be raised by 0.25%. See "State Finances—Sources of Tax Revenue—Sales Tax" above.

The 2001-02 Governor's Budget released on January 10, 2001, provided updated 2000-01 revenue and expenditure estimates. These estimates were further updated on May 14, 2001, with the release of the May Revision to the Governor's Budget (the "May Revision"). The May Revision stated that General Fund revenues in 2000-01 are estimated to be \$78.0 billion, \$4.1 billion above the 2000 Budget Act estimates and \$1.1 billion above the 2001-02 Governor's Budget estimate, reflecting the continuing positive revenue impact of the State's strong economy in 2000. Expenditures in 2000-01 were estimated to be \$80.2 billion, about \$1.4 billion above the Budget Act estimates. The Department of Finance estimated in the May Revision that the June 30, 2001 SFEU balance, the budget reserve, will be approximately \$5.9 billion, a substantial increase over the Budget Act estimate of \$1.78 billion. This reserve is being used to provide advances to support the Department of Water Resources power purchase program (see "Recent

Development Regarding Energy” above). Even with these advances, the Administration does not expect the need to utilize any significant amount of internal borrowing from other State funds prior to the end of the fiscal year.

### **Fiscal Year 2001-02 Budget**

The 2001-02 Governor’s Budget, released January 10, 2001, estimated 2001-02 General Fund revenues and transfers to be about \$79.4 billion, and proposed \$82.9 billion in expenditures, utilizing a portion of the surplus expected from 2000-01. The Governor proposed budget reserves in 2001-02 of \$2.4 billion, including \$500 million for unplanned litigation costs.

The May Revision disclosed a reversal of the recent General Fund financial trend, as a result of the slowdown in economic growth in the State starting in the first quarter of 2001 and, most particularly, the steep drop in stock market levels since early 2000. See “Revenue and Expenditure Assumptions” below. The May Revision projects General Fund revenues in 2001-02 will be about \$74.8 billion, a drop of \$3.2 billion from revised 2000-01 estimates and \$4.6 billion below the estimate in the 2001-02 Governor’s Budget. Most of the drop is attributed to the personal income tax, which reflects both slower job and wage growth, and a severe decline in capital gains and stock option income, which is included in personal income tax statistics. Lower corporate earnings are projected to result in a drop in the corporate income tax, and sales taxes are projected to increase slightly.

The May Revision also stated that spending requirements for 2000-01 and 2001-02 would be higher than estimated in the 2001-02 Governor’s Budget, principally because of higher retirement costs and increased school spending due to higher population than originally estimated. In the May Revision, the Administration proposed a series of actions to address these increased costs and decreased revenues. The proposals assume that the State will issue revenue bonds to repay the loans which have been made from the General Fund to pay for energy purchases since January 2001, so that a General Fund surplus (including reserves) of almost \$6 billion will be available to pay for programs in 2001-02. See “Recent Developments Regarding Energy” above.

The principal elements included in the May Revision were: (1) reduction in budget and litigation reserves to \$1.1 billion from \$2.4 billion, (2) postponement of the allocation from the General Fund to transportation programs of \$1.3 billion in 2001-02 and \$1.2 billion in 2002-03 of sales tax receipts on gasoline sales, with a corresponding extension by two years of the Governor’s transportation initiatives first enacted in the 2000 Budget Act, (3) reduction of \$400 million of proposals from the 2001-02 Governor’s Budget for one-time non-capital outlay expenditures for a variety of programs, including local government fiscal relief, housing and environmental programs, (4) shift of \$390 million of non-transportation capital outlay projects from “pay-as-you-go” to debt financing, (5) transfer of \$600 million of other special funds to the General Fund, and (6) other budget reductions totaling over \$1 billion. Total spending for K-12 schools and community colleges is proposed to increase over 2000-01. The overall spending plan for 2001-02 contained in the May Revision totals \$79.7 billion, almost \$600 million below projected expenditures in 2000-01, and \$3.2 billion below the 2001-02 Governor’s Budget proposal. The final 2001 Budget Act will depend on further negotiations between the Administration and the Legislature.

# Summary of State Revenues and Expenditures

## STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE—GENERAL FUND (Budgetary Basis)(a) FISCAL YEARS 1997-98 THROUGH 2001-02 (Millions)

	1997-98	1998-99	1999-00	Estimated <sup>(b)</sup> 2000-01 <sup>(c)</sup>	Proposed 2001-02 <sup>(c)</sup>
<b>Fund Balance—Beginning of Period</b>	\$ 639.8	\$ 2,792.5	\$ 3,907.7	\$ 9,639.7	\$ 6,644.7
Restatements					
Prior Year Revenue, Transfer					
Accrual Adjustments.....	(165.3)	(147.1)	(204.6)	(0.8)	--
Prior Year Expenditure, Accrual					
Adjustments.....	498.1	162.3	217.1	(790.9)	--
<b>Fund Balance—Beginning of Period, as Restated.....</b>	<b>\$ 972.6</b>	<b>\$ 2,807.7</b>	<b>\$ 3,920.2</b>	<b>\$ 8,848.0</b>	<b>\$ 6,644.7</b>
Revenues.....	\$54,797.7	\$58,935.1	\$71,555.6	\$77,961.3	\$74,066.9
Other Financing Sources					
Transfers from Other Funds.....	132.0	93.9	423.3	81.4	775.6
Other Additions.....	154.4	339.4	48.1	--	--
<b>Total Revenues and Other Sources.....</b>	<b>\$55,084.1</b>	<b>\$59,368.4</b>	<b>\$72,027.0</b>	<b>\$78,042.7</b>	<b>\$74,842.5</b>
Expenditures					
State Operations.....	\$14,042.1	\$14,775.8	\$15,942.8	\$17,983.1	\$19,075.5
Local Assistance.....	38,990.4	42,260.3	49,974.7	59,821.0	60,206.5
Capital Outlay.....	57.2	235.7	186.2	2,438.8	394.2
Unclassified.....				3.0	
Other Uses					
Transfer to Other Funds.....	174.5	996.6	203.8	-- <sup>(d)</sup>	-- <sup>(d)</sup>
<b>Total Expenditures and Other Uses.....</b>	<b>\$53,264.2</b>	<b>\$58,268.4</b>	<b>\$66,307.5</b>	<b>\$80,245.9</b>	<b>\$79,676.2</b>
<b>Revenues and Other Sources Over or (Under) Expenditures and Other Uses --</b>	<b>\$ 1,819.9</b>	<b>\$ 1,100.0</b>	<b>\$ 5,719.5</b>	<b>\$ (2,203.2)</b>	<b>\$ (4,833.7)</b>
Fund Balance					
Reserved for Encumbrances.....	\$ 478.7	\$ 592.0	\$ 701.3	\$ 701.3	\$ 701.3
Reserved for Unencumbered Balances of Continuing Appropriations <sup>(e)</sup> .....	122.8	697.6	1,115.2	912.5	413.8
Reserved for School Loans <sup>(f)</sup> .....	1,259.7	1,009.7	699.7	349.7	--
Unreserved—Undesignated <sup>(g)</sup> .....	931.3	1,608.4	7,123.5	4,681.2	695.9
<b>Fund Balance—End of Period.....</b>	<b>\$ 2,792.5</b>	<b>\$ 3,907.7</b>	<b>\$ 9,639.7</b>	<b>\$ 6,644.7</b>	<b>\$ 1,811.0</b>

Footnotes on following page.

SOURCE: Fiscal years 1997-98 to 1999-00: State of California, Office of the State Controller.  
Fiscal years 2000-01 and 2001-02: State of California, Department of Finance.

- (a) These statements have been prepared on a budgetary basis in accordance with State law and some modifications would be necessary in order to comply with generally accepted accounting principles ("GAAP"). The audited general purpose financial statements of the State contain a description of the differences between the budgetary basis and the GAAP basis of accounting. See "Financial Statements" below.
- (b) Estimates are shown net of reimbursements and abatements.
- (c) Estimated as of the 2001-02 May Revision released on May 14, 2001. The final 2001-02 Budget will depend on agreements between the Legislature and the Governor.
- (d) "Transfer to Other Funds" is included either in the expenditure totals detailed above or as "Transfer from Other Funds."
- (e) For purposes of determining whether the General Fund budget, in any given fiscal year, is in a surplus or deficit condition, Chapter 1238, Statutes of 1990, amended Government Code Section 13307. As part of the amendment, the unencumbered balances of continuing appropriations which exist when no commitment for an expenditure is made should be an item of disclosure, but the amount shall not be deducted from the fund balance. Accordingly, the General Fund condition included in the 2001-02 Governor's Budget includes the unencumbered balances of continuing appropriations as a footnote to the statement (\$1.483 billion in 1999-00, \$912.5 million in 2000-01 and \$413.8 million in 2001-02). However, in accordance with Government Code Section 12460, the State's Budgetary/Legal Basis Annual Report reflects a specific reserve for the unencumbered balance for continuing appropriations.
- (f) During 1995, a reserve was established in the General Fund balance for the \$1.7 billion of previously recorded school loans which had been authorized by Chapter 703, Statutes of 1992 and Chapter 66, Statutes of 1993. These loans are to be repaid from future General Fund appropriations. See "State Finances - Proposition 98" above for a discussion of the settlement of the *CTA v. Gould* lawsuit. This accounting treatment is consistent with the State's audited financial statements prepared in accordance with GAAP.
- (g) Includes Special Fund For Economic Uncertainties (SFEU). The State Controller reports the balance in the SFEU as of June 30, 2000, to be \$3.777 billion. This amount includes a computation by the State Controller of the transfer pursuant to Government Code §16418(e) (see "State Finances - The Special Fund for Economic Uncertainties" above) based on the State Appropriations Limit information contained in the 2000-01 Governor's Budget. The Department of Finance generally includes in its estimates of the SFEU and set-aside reserves, if any, the items reported in the table under "Reserved for Unencumbered Balances of Continuing Appropriations," "Reserved for School Loans," and "Unreserved-Undesignated." The 2001-02 May Revision projects the SFEU to be \$5.936 billion on June 30, 2001, and \$1.010 billion on June 30, 2002. Additionally, the Budget includes a set-aside for legal contingencies of \$7.0 million in 2000-01 and \$100.0 million in 2001-02. If not expended, this set-aside will become part of the SFEU.

## Revenue and Expenditure Assumptions

The table below presents the Department of Finance's budget basis statements of major General Fund revenue sources and expenditures for the 1999-00 fiscal year and the 2001-02 May Revision estimates for the 2000-01 and 2001-02 fiscal years.

<u>Source</u>	<b>Revenues (Millions)</b>			
	<b>Fiscal Years</b>			
	<b>1999-00<sup>(a)</sup></b>	<b>2000-01<sup>(b)</sup></b>	<b>2000-01<sup>(c)</sup></b>	<b>2001-02<sup>(c)</sup></b>
	<u>Actual</u>	<u>Enacted</u>	<u>Revised</u>	<u>Proposed</u>
Personal Income Tax.....	\$39,575	\$41,339	\$44,760	\$42,114
Sales and Use Tax.....	21,137	21,318	21,550	21,985
Bank and Corporation Tax.....	6,639	6,800	6,583	5,873
Insurance Tax.....	1,300	1,321	1,470	1,452
All Other.....	<u>3,280<sup>(d)</sup></u>	<u>3,084<sup>(e)</sup></u>	<u>3,680</u>	<u>3,388</u>
Total Revenues and Transfers	<u>\$71,931</u>	<u>\$73,862</u>	<u>\$78,043</u>	<u>\$74,842</u>

<u>Function</u>	<b>Expenditures (Millions)</b>			
	<b>Fiscal Years</b>			
	<b>1999-00<sup>(a)</sup></b>	<b>2000-01<sup>(b)</sup></b>	<b>2000-01<sup>(c)</sup></b>	<b>2001-02<sup>(c)</sup></b>
	<u>Actual</u>	<u>Enacted</u>	<u>Revised</u>	<u>Proposed</u>
K-12 Education.....	\$27,588	\$30,603	\$29,976	\$33,216
Health and Human Services.....	17,531	20,284	20,127	21,811
Higher Education.....	8,021	9,445	9,357	10,081
Youth and Adult Correctional.....	4,748	5,179	5,199	5,300
Legislative, Judicial and Executive.....	2,288	2,616	2,670	2,630
Tax Relief.....	1,842	4,488	4,709	3,055
Resources.....	1,184	1,599	2,459	1,324
State and Consumer Services.....	481	533	578	593
Business, Transportation and Housing.....	394	2,586	2,579	746
All Other.....	<u>2,417</u>	<u>1,483</u>	<u>2,592</u>	<u>872</u>
Total Expenditures	<u>\$66,494</u>	<u>\$78,866</u>	<u>\$80,246</u>	<u>\$79,676</u>

(a) Figures for 1999-00, prepared by the Department of Finance, are slightly different than the figures on page A-27, prepared by the State Controller's Office, because of certain differences in accounting methods used by the two offices.

(b) 2000 Budget Act, June 30, 2000.

(c) 2001-02 May Revision, May 14, 2001.

(d) Includes \$515 million from tobacco litigation settlement payment.

(e) Includes \$383 million from tobacco litigation settlement payment.

SOURCE: State of California, Department of Finance.

The Revenue and Expenditure assumptions set forth have been based upon certain estimates of the performance of the California and national economies in calendar years 2001 and 2002. In the 2001-02 May Revision released on May 14, 2001, the Department of Finance projected that the California economy will continue to grow, but at a more moderate pace. U.S. economic growth has been slower than expected in recent months, and the national slowdown has begun to affect California. Despite a recent rally, stock prices—especially in the high-technology sector—are lower than projected in January. Additionally, while the energy crisis has not yet directly affected the national or California economy, rising wholesale energy costs are expected to have a ripple effect throughout the western United States. Reflecting these developments, forecasts of most economic indicators have been revised down from the 2001-02 Governor's Budget as released in January 2001.

The California economy avoided the national slowdown during the second half of 2000, entering 2001 with very strong momentum. The State accounted for more than two-thirds of all new jobs created in the nation on an April 2000-to-April 2001 comparison. Of particular note, manufacturing employment, down by 553,000 nationwide over the past year, actually posted a 12,000-job gain in California on a April-to-April comparison.

Although California's growth continues to outpace the nation by a wide margin, the State is clearly not immune to a nationwide slowdown in economic activity. The early months of 2001 revealed a significant moderation in the State's economic growth. Gains in nonfarm employment, which averaged more than 150,000 each quarter during 2000, slowed to only 41,500 during the first three months of 2001.

In addition, announcements by several of the State's major companies point to a softening in high-tech jobs in the months ahead. However, to an increasing degree, California companies specialize in the advanced stages of design, research, and development, rather than the actual manufacturing of finished goods and components. Because most technology-oriented firms are reluctant to cut future product development, the effects of the weakness in high-technology goods and services are likely to be somewhat muted in California.

Given the recent slowing of job growth, non-farm employment this year is likely to moderate to 2.3 percent growth, down from 3.8 percent in 2000. Even though some pickup is projected in 2002, year average growth is expected to be under 2 percent. The unemployment rate—a lagging indicator—is forecast to edge up to 5 percent this year from a 4.9 percent average in 2000, and rise further to 5.7 percent in 2002.

Construction trends are expected to be mixed. Low interest rates and a large backlog of unmet demand should encourage further gains in new residential construction, with 160,000 new units authorized by building permits in 2001, up from 150,000 in 2000. Next year, homebuilding is expected to reach 166,000 units.

Although California has avoided the commercial construction excesses of the 1980s, slower job growth, coupled with new supply already under construction, will result in rising commercial and retail vacancy rates, which in turn will discourage new construction starts. After



several years of strong double-digit growth, nonresidential permit values (not adjusted for inflation) are expected to slow to 6.4 percent growth this year and 2.6 percent in 2002.

*The Stock Market and Personal Income.* Much of last year's extraordinary income growth reflected a surge in stock option incomes—counted in wages and salaries—reflecting the “bubble” in the technology-heavy NASDAQ index that more than doubled in value between mid-October 1999 and early March 2000. Of the \$81 billion increase in wages and salaries last year, the Department of Finance estimates that \$34 billion or 42 percent was attributable to the increase in the value of stock options exercised.

As a result of the collapse of this bubble, the projected slowdown in personal income growth—from a 16-year high of 11.5 percent in 2000, to only 2 percent in 2001—is far greater than warranted by the moderation in job gains from 3.8 percent last year to 2.3 percent in 2001. With the NASDAQ having now given up nearly 60 percent from the March 5, 2000 peak, it seems virtually certain that option-generated incomes will fall from last year's elevated levels. However, forecasting this increasingly important but extremely volatile element of income involves assumptions both about stock prices over the remainder of 2001 and about the behavior of option holders.

Lower stock prices reduce the value of each option exercised, especially since the strike price (the price at which the option holder actually “buys” the shares) rises over time. In addition, it seems likely that skyrocketing stock prices last year encouraged the exercise of more options than would have occurred under more ordinary circumstances. Thus, some of last year's options were accelerated from 2001 and future years.

This forecast assumes that option-related incomes in 2001 will drop back to near 1999-levels, representing a decline of about 37 percent, or \$31 billion, from 2000. This assumption allows for some further recovery in the NASDAQ, which averaged about 2800 in 1999, about 600 points higher than the early May trading range.

To illustrate the impact of this assumption on personal income, if stock option-related incomes were held constant, 2001 personal income growth in this forecast would be 7.6 percent rather than 2 percent. Because much of this option income is taxed at or near the top 9.3 percent personal income tax rate, the effect on General Fund revenues is even larger than implied by the effect on household incomes.

In addition to options, the stock market also affects personal income tax revenues through capital gains on the sale of stocks and the gains realized within mutual funds. These gains are excluded from the economic measure of personal income.

The Department set out the following estimates for the State's economic performance which were used in predicting revenues and expenditures for the 2001-02 May Revision. Also shown was the Department's previous forecast for 2001 and 2002, contained in the 2001-02 Governor's Budget.

	For 2001		For 2002	
	May Revision <sup>(a)</sup>	Governor's Budget <sup>(b)</sup>	May Revision <sup>(a)</sup>	Governor's Budget <sup>(b)</sup>
Nonfarm wage and salary employment (000)	14,864	14,929	15,116	15,333
Percent Change	2.3%	2.8%	1.7%	2.7%
Personal income (\$ billions)	\$1,128	\$1,171	\$1,191	\$1,253
Percent Change	2.0%	5.7%	5.6%	6.9%
Housing Permits (Units 000)	160	155	166	167
Consumer Price Index (% change)	4.5%	3.1%	2.4%	2.5%

(a) 2001-02 May Revision: May 14, 2001.

(b) 2001-02 Governor's Budget: January 10, 2001.

SOURCE: State of California, Department of Finance.

## FINANCIAL STATEMENTS

Audited General Purpose Financial Statements of the State of California (the "Financial Statements") are available for the year ended June 30, 2000. Such Financial Statements have been filed with all of the Nationally Recognized Municipal Securities Information Repositories as part of the Official Statement for State General Obligation Bonds sold previously this year, and are incorporated by reference into this Appendix. Potential investors may obtain or review a copy of the Financial Statements from the following sources:

1. By obtaining from any Nationally Recognized Municipal Securities Information Repository, or any other source, a copy of the State of California's Official Statement dated February 27, 2001, relating to the issuance of \$600,000,000 of General Obligation Bonds and \$354,430,000 General Obligation Refunding Bonds. The Financial Statements are printed in full in such Official Statement. No part of the February 27, 2001 Official Statement *except* the Financial Statements is incorporated into this document.
2. By accessing the Internet Website of the State Controller ([www.sco.ca.gov](http://www.sco.ca.gov)) and clicking on the icons for "Publications;" "State and Local Government Financial Reports;" and "Comprehensive Annual Financial Report -2000" in that order or by contacting the Office of the State Controller at (916) 445-2636.
3. By accessing the Internet Website of the State Treasurer ([www.treasurer.ca.gov](http://www.treasurer.ca.gov)) and clicking on the icons for "Financial Information" and "Audited General Purpose Financial Statements" in that order, or by contacting the Office of the State Treasurer at (800) 900-3873.

Certain unaudited financial information for the period July 1 – December 31, 2000 is also included as Exhibit 1 to Appendix A.

Periodic reports on revenues and/or expenditures during the fiscal year are issued by the Administration, the State Controller's Office and the Legislative Analyst's Office. The

Department of Finance issues a monthly Bulletin which reports the most recent revenue receipts as reported by State departments, comparing them to budget projections. The Administration also formally updates its budget projections three times during each fiscal year, in January, May, and at budget enactment. These bulletins and reports are available on the Internet at websites maintained by the agencies and by contacting the agencies at their offices in Sacramento, California. Such bulletins and reports are not part of or incorporated into this Official Statement. Investors are cautioned that interim financial information is not necessarily indicative of results for a fiscal year.

## **ECONOMY AND POPULATION**

### **Introduction**

California's economy, the largest among the 50 states and one of the largest in the world, has major components in high technology, trade, entertainment, agriculture, manufacturing, tourism, construction and services. Since 1994, California's economy has been performing strongly after suffering a deep recession between 1990-93.

Fuel and other energy prices have risen sharply in recent months. The State Department of Finance notes that the State and national economies are much more energy-efficient than during the energy crises of the 1970s and early 1980s, and that, adjusted for inflation, motor fuel prices are still 20 percent below the 1981 level. See "Recent Developments Regarding Energy" above.

### **Population and Labor Force**

The State's July 1, 2000 population of over 34 million represented over 12 percent of the total United States population.

California's population is concentrated in metropolitan areas. As of the April 1, 2000 census, 97 percent resided in the 25 Metropolitan Statistical Areas in the State. As of July 1, 2000, the 5-county Los Angeles area accounted for 48 percent of the State's population, with over 16.0 million residents, and the 10-county San Francisco Bay Area represented 21 percent, with a population of over 7.0 million.

The following table shows California's population data for 1994 through 2000.

**Population 1994-00**

<b>Year</b>	<b>California Population<sup>(a)</sup></b>	<b>% Increase Over Preceding Year</b>	<b>United States Population<sup>(a)</sup></b>	<b>% Increase Over Preceding Year</b>	<b>California as % of United States</b>
1994	32,155,000	0.5%	260,327,000	1.0%	12.4%
1995	32,291,000	0.4	262,803,000	1.0	12.3
1996	32,501,000	0.7	265,229,000	0.9	12.3
1997	32,985,000	1.5	267,784,000	1.0	12.3
1998	33,387,000	1.2	270,248,000	0.9	12.4
1999	33,934,000	1.6	272,691,000	0.9	12.4
2000	34,480,000	1.6	275,130,000	0.9	12.5

(a) Population as of July 1.

SOURCE: U. S. figures from U.S. Department of Commerce, Bureau of the Census; California figures from State of California, Department of Finance.

The following table presents civilian labor force data for the resident population, age 16 and over, for the years 1993 to 2000.

**Labor Force  
1993-00**

<b>Year</b>	<b>Labor Force Trends (Thousands)</b>		<b>Unemployment Rate (%)</b>	
	<b>Labor Force</b>	<b>Employment</b>	<b>California</b>	<b>United States</b>
1993	15,360	13,918	9.4%	6.9%
1994	15,450	14,122	8.6	6.1
1995	15,412	14,203	7.8	5.6
1996	15,512	14,392	7.2	5.4
1997	15,947	14,943	6.3	4.9
1998	16,337	15,368	5.9	4.5
1999	16,597	15,732	5.2	4.2
2000	17,091	16,246	4.9	4.0

SOURCE: State of California, Employment Development Department.

## Employment, Income, Construction and Export Growth

The following table shows California's nonagricultural employment distribution and growth for 1990 and 2000.

Payroll Employment By Major Sector 1990 and 2000				
Industry Sector	Employment (Thousands)		% Distribution of Employment	
	1990	2000	1990	2000
Mining.....	38.9	23.3	0.3%	0.2%
Construction.....	605.3	733.6	4.8	5.1
Manufacturing				
Nondurable goods.....	720.6	726.5	5.7	5.0
High Technology .....	686.0	513.9	5.4	3.5
Other Durable Goods.....	690.3	703.8	5.5	4.8
Transportation and Utilities.....	623.9	745.6	4.9	5.1
Wholesale and Retail Trade .....	3,002.2	3,300.8	23.7	22.7
Finance, Insurance				
And Real Estate .....	824.6	823.2	6.5	5.7
Services.....	3,395.3	4,626.8	26.8	31.9
Government				
Federal .....	362.1	274.4	2.9	1.9
State and Local .....	<u>1,712.7</u>	<u>2,046.9</u>	<u>13.5</u>	<u>14.1</u>
TOTAL				
NONAGRICULTURAL...	<u>12,661.9</u>	<u>14,518.8</u>	<u>100%</u>	<u>100%</u>

SOURCE: State of California, Employment Development Department and State of California, Department of Finance.

The following tables show California's total and per capita income patterns for selected years.

### Total Personal Income 1993-99<sup>(a)</sup>

Year	California		
	Millions	% Change <sup>(b)</sup>	California % of U.S.
1993.....	\$714,107	1.8%	12.8%
1994 <sup>(c)</sup> .....	735,104	2.9	12.5
1995.....	771,470	4.9	12.5
1996.....	812,404	5.3	12.4
1997.....	862,114	6.1	12.4
1998.....	924,253	7.2	12.5
1999.....	991,382	7.3	12.7

(a) Historical personal income series revised by BEA, released May 17, 2000, & September 12, 2000.

(b) Change from prior year.

(c) Reflects Northridge earthquake, which caused an estimated \$15 billion drop in personal income.

Note: Omits income for government employees overseas.

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis (BEA).

**Per Capita Personal Income 1993-99<sup>(a)</sup>**

<u>Year</u>	<u>California</u>	<u>% Change<sup>(b)</sup></u>	<u>United States</u>	<u>% Change<sup>(b)</sup></u>	<u>California % of U.S.</u>
1993.....	\$ 22,927	0.9%	\$21,718	3.0%	105.6%
1994 <sup>(c)</sup> .....	23,473	2.4	22,581	4.0	104.0
1995.....	24,496	4.4	23,562	4.3	104.0
1996.....	25,563	4.4	24,651	4.6	103.7
1997.....	26,759	4.7	25,874	5.0	103.4
1998.....	28,280	5.7	27,322	5.6	103.5
1999.....	29,910	5.8	28,542	4.5	104.8

(a) Historical personal income series revised by BEA, released May 17, 2000 & September 12, 2000.

(b) Change from prior year.

(c) Reflects Northridge earthquake, which caused an estimated \$15 billion drop in personal income.

Note: Omits income for government employees overseas.

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis (BEA).

The following tables show California's residential and nonresidential construction authorized by permits for selected years.

**Residential Construction Authorized by Permits**

<u>Year</u>	<u>Units</u>			<u>Valuation <sup>(a)</sup> (millions)</u>
	<u>Total</u>	<u>Single</u>	<u>Multiple</u>	
1995	85,293	68,689	16,604	\$13,879
1996	94,283	74,923	19,360	15,289
1997	111,716	84,780	26,936	18,752
1998	125,707	94,298	31,409	21,976
1999	140,137	101,711	38,426	25,783
2000	148,540	105,595	42,945	28,142

(a) Valuation includes additions and alterations.

SOURCE: Construction Industry Research Board

**Nonresidential Construction**  
(Thousands of dollars)

<u>Year</u>	<u>Commercial</u>	<u>Industrial</u>	<u>Other</u>	<u>Additions and Alterations</u>	<u>Total</u>
1995	\$2,308,912	\$ 732,877	\$1,050,684	\$4,062,271	\$ 8,154,744
1996	2,751,909	1,140,575	1,152,425	4,539,219	9,584,128
1997	4,271,378	1,598,428	1,378,220	5,021,792	12,269,818
1998	5,419,251	2,466,530	1,782,337	5,307,901	14,976,019
1999	5,706,719	2,256,166	2,350,213	6,269,194	16,582,292
2000	6,962,021	2,206,168	2,204,745	7,251,987	18,624,921

SOURCE: Construction Industry Research Board

The following table shows California's export growth for the period from 1995 through 2000.

**Exports Through California Ports**  
(In millions)

<u>Year</u>	<u>Exports <sup>(a)</sup></u>	<u>% Change</u>
1995	\$ 116,825.5	22.2%
1996	124,120.0	6.2
1997	131,142.7	5.7
1998	116,282.4	-11.3
1999	122,092.8	5.0
2000	148,554.6	21.7

(a) "free along ship" Value Basis

SOURCE: U.S. Department of Commerce, Bureau of the Census

## LITIGATION

The State is a party to numerous legal proceedings. The following are the most significant pending proceedings, as reported by the Office of the Attorney General. See "Litigation" in the main body of this Official Statement.

On June 24, 1998, plaintiffs in *Howard Jarvis Taxpayers Association et al. v. Kathleen Connell* filed a complaint for certain declaratory and injunctive relief challenging the authority of the State Controller to make payments from the State Treasury in the absence of a State budget. On July 21, 1998, the trial court issued a preliminary injunction prohibiting the State Controller from paying moneys from the State Treasury for fiscal year 1998-99, with certain limited exceptions, in the absence of a State budget. The preliminary injunction, among other things, prohibited the State Controller from making any payments pursuant to any continuing appropriation. On July 22 and 27, 1998, various employee unions which had intervened in the case appealed the trial court's preliminary injunction and asked the Court of Appeal to stay the preliminary injunction. On July 28, 1998, the Court of Appeal granted the unions' requests and

stayed the preliminary injunction pending the Court of Appeal's decision on the merits of the appeal. On August 5, 1998, the Court of Appeal denied the plaintiffs' request to reconsider the stay. Also on July 22, 1998, the State Controller asked the California Supreme Court to immediately stay the trial court's preliminary injunction and to overrule the order granting the preliminary injunction on the merits. On July 29, 1998, the Supreme Court transferred the State Controller's request to the Court of Appeal. The matters are now pending before the Court of Appeal. Briefs have been submitted; no date has yet been set for oral argument.

The State is involved in ongoing litigation, *Hayes v. Commission on State Mandates*, related to State mandate test claims, initially filed in 1980 and 1981, concerning the costs of providing special education programs and services to disabled children. After 20 years of litigation, on October 26, 2000, the Governor announced that the parties had agreed, in principle, to a settlement under which schools would receive (1) \$520 million in retroactive payments -- \$270 million immediately, plus \$25 million for the next 10 years, and (2) \$100 million per year for ongoing costs. All school districts, county offices of education, and Special Education Local Planning Areas have approved the settlement and legislation ratifying the settlement (Senate Bill 982) is currently in the Assembly.

In January of 1997, California experienced major flooding with preliminary estimates of property damage of approximately \$1.6 to \$2.0 billion. In *McMahon v. State*, a substantial number of plaintiffs have joined suit against the State, local agencies, and private companies and contractors seeking compensation for the damages they suffered as a result of the 1997 flooding. After various pre-trial proceedings, the State filed its answer to the plaintiffs' complaint in January of 2000. No trial date has been set. The State is vigorously defending the action.

The State is involved in a lawsuit related to contamination at the Stringfellow toxic waste site. In *United States, California v. J.B. Stringfellow, Jr., et al.*, the State is seeking recovery for past costs of cleanup of the site, a declaration that the defendants are jointly and severally liable for future costs, and an injunction ordering completion of the cleanup. However, the defendants have filed a counterclaim against the State for alleged negligent acts, resulting in significant findings of liability against the State as owner, operator, and generator of wastes taken to the site. The State has appealed the rulings. Present estimates of the cleanup range from \$400 million to \$600 million. Potential State liability falls within this same range. However, all or a portion of any judgment against the State could be satisfied by recoveries from the State's insurance carriers. The State has filed a suit against certain of these carriers. The trial on the coverage action is not expected to begin until 2002.

The State is a defendant in *Paterno v. State of California*, a coordinated action involving 3,000 plaintiffs seeking recovery for damages caused by the Yuba River flood of February 1986. The trial court found liability in inverse condemnation and awarded damages of \$500,000 to a sample of plaintiffs. The State's potential liability to the remaining plaintiffs ranges from \$800 million to \$1.5 billion. In 1992, the State and plaintiffs filed appeals. In August 1999, the Court of Appeal issued a decision reversing the trial court's judgment against the State and remanding the case for retrial on the inverse condemnation cause of action. The California Supreme Court denied plaintiffs' petition for review. Retrial is presently underway in Yuba County.

In *County of San Bernardino v. State Department of Health Services and Barlow*



*Respiratory Hospital v. State Department of Health Services*, which are being tried together in state court, plaintiffs seek mandamus relief requiring the State to retroactively increase outpatient Medi-Cal reimbursement rates. Plaintiffs in *Orthopedic Hospital v. Belshe*, a federal court action, seek the same relief on a prospective basis. Plaintiffs in the state court action have estimated that the retroactive damages could exceed \$500 million. Should prospective relief be granted, the State's costs could increase by more than \$100 million per year in future years. The State is vigorously defending these cases. The trial in the *County of San Bernardino* and *Barlow* cases is scheduled to have three phases: law, fact and remedy phases. The state court litigation has been stayed pending settlement negotiations which have resulted in settlement of all three cases for \$350 million in retroactive payments and a 30 percent increase in reimbursement rates beginning July 1, 2001, with 3.33 percent increases in each of the following three years. This settlement is subject to approval by the United States Department of Health and Human Services, Health Care Financing Administration.

The State is involved in three refund actions, *California Assn. Of Retail Tobacconists (CART), et al. v. Board of Equalization, et al., Cigarettes Cheaper!, et al. v. Board of Equalization, et al.* and *McLane/Suneast, et al. v. Board of Equalization, et al.*, that challenge the constitutionality of Proposition 10, which the voters passed in 1998 to establish the Children and Families Commission and local county commissions and to fund early childhood development programs. *CART* and *Cigarettes Cheaper!* allege that Proposition 10, which increases the excise tax on tobacco products, violates 11 sections of the California Constitution and related provisions of law. *McLane/Suneast* challenges only the "double tax" aspect of Proposition 10. Trial of these three consolidated cases commenced on September 15, 2000, and concluded on November 15, 2000. A final statement of decision issued on December 7, 2000, and judgment in favor of all defendants as to all 30 consolidated counts was entered on January 9, 2001. The *McLane/Suneast* and U.S. Tobacco plaintiffs timely appealed all "double tax" issues, and the *CART* plaintiffs and *Cigarettes Cheaper!* plaintiffs timely appealed these and all other issues. Due to the facial challenge, there is exposure as to the entire \$750 million per year collected under Proposition 10 together with interest, which could amount to several billion dollars by the time the case is finally resolved.

In *FORCES Action Project et al. v. State of California et al.*, various smokers rights groups challenge the tobacco settlement as it pertains to California, Utah and the City and County of San Francisco. Plaintiffs assert a variety of constitutional challenges, including that the settlement represents an unlawful tax on smokers. Motions to dismiss by all defendants, including the tobacco companies, were eventually converted to summary judgment motions by the court and heard on September 17, 1999. On January 5, 2000, the court dismissed the complaint for lack of subject matter jurisdiction because the plaintiffs lacked standing to sue. The court also concluded that the plaintiffs' claims against the State and its officials are barred by the 11th Amendment. Plaintiffs have appealed. Briefing has been completed. Oral argument has been set for June 14, 2001.

*Arnett v. California Public Employees Retirement System, et al.* was filed by seven former employees of the State of California and local agencies, seeking back wages, damages and injunctive relief. Plaintiffs are former public safety members who began employment after the age of 40 and are recipients of Industrial Disability Retirement ("IDR") benefits. Plaintiffs

contend that the formula which determines the amount of IDR benefits violates the federal Age Discrimination in Employment Act of 1967 ("ADEA"). Plaintiffs contend that, but for their ages at hire, they would receive increased monthly IDR benefits similar to their younger counterparts who began employment before the age of 40. CalPERS has estimated the liability to the State as approximately \$315.5 million were the plaintiffs to prevail. The District Court dismissed the complaint for failure to state a claim. On August 17, 1999, the Ninth Circuit Court of Appeals reversed the District Court's dismissal of the complaint. The State sought further review in the United States Supreme Court. On January 11, 2000, the United States Supreme Court in *Kimel v. Florida Board of Regents*, held that Congress did not abrogate the sovereign immunity of the states when it enacted the ADEA. Thereafter, on January 18, 2000, the Supreme Court granted the petition for writ of certiorari in *Arnett*, vacated the judgment of the Ninth Circuit, and remanded the case to the Ninth Circuit for further proceedings consistent with *Kimel*. In turn, the Ninth Circuit remanded the case to the District Court. Thereafter, the EEOC intervened in this action. In December 2000, the State filed a motion for summary judgment based on sovereign immunity and constitutional grounds. The parties are engaged in settlement discussions. No trial date is set.

On March 30, 2000, a group of students, parents, and community based organizations brought suit, on behalf of the school children of the Los Angeles Unified School District, against the State Allocation Board ("SAB"), the State Office of Public School Construction ("OPSC") and a number of State officials (*Godinez, et al. v. Davis, et al.*) in the Superior Court in the County of Los Angeles. The lawsuit principally alleges SAB and OPSC have unconstitutionally and improperly allocated new public school construction funds to local school districts for new public school construction as authorized by the Class Size Reduction Kindergarten-University Public Education Facilities Bond Act (hereafter referred to as "Proposition 1A"). Plaintiffs seek only prospective relief, alleging that the current SAB method of allocating new construction funds is neither reasonable nor fair to large, urban school districts. The Plaintiffs allege the present allocation method does not dispense new construction funds on a priority of greatest need basis. On December 13, 2000, the parties reached an agreement under which plaintiffs and intervenors agree that the regulations adopted by the State Allocation Board at its meeting of that date, adequately address the needs of LAUSD. Assuming no future substantive changes in the regulations, the lawsuit will not go forward and will eventually be dismissed. On or about December 8, 2000, a related lawsuit was filed in Sacramento County Superior Court by the Coalition for Adequate School Housing ("CASH"). That case has since been transferred to Los Angeles County Superior Court. CASH seeks a writ of mandate against the State Allocation Board to prevent the distribution of new school construction funds according to the newly adopted regulations. CASH seeks distribution of the new school construction funds on a first come, first served basis. The SAB has filed an answer. The Attorney General is of the opinion that neither the Godinez nor the CASH lawsuit affects the validity of any State bonds, nor the authority of the State to issue bonds under the current authorization granted by the finance committees.

In *Charles Davis v. California Health and Human Services Agency*, the plaintiff has brought a class action under a number of federal acts, including the Americans with Disabilities Act, seeking declaratory and injunctive relief, alleging that persons who are institutionalized with disabilities at a San Francisco run 1,200 bed skilled nursing facility (Laguna Honda) who require

long term care should be assessed as to whether they can be treated at home or in community-based facilities, and then provided appropriate care. The State has filed an answer. At this early stage in the proceedings, it is difficult to assess the financial impact of a judgment against the State. However, should the plaintiffs prevail, the State's liability could exceed \$400 million. The State is vigorously defending this action.

In *Stephen Sanchez, et al. v. Grantland Johnson et al.*, the plaintiffs have brought a class action in Federal District Court for the Northern District of California, seeking declaratory and injunctive relief, alleging, in part, that provider rates for community-based services for developmentally disabled individuals are discriminatory under the Americans with Disabilities Act, and violate Social Security Act, Civil Rights Act and the Rehabilitation Act, because they result in unnecessary institutionalization of developmentally disabled persons. The State has filed a responsive pleading and is vigorously contesting this case. At this early stage in the proceedings, it is difficult to assess the financial impact of a judgment against the State. However, should the plaintiffs prevail, the State's liability could exceed \$400 million.

### **Litigation Relating to Energy Matters**

#### **Actions Seeking Compensation for Block Forward Contracts Commandeered by the Governor**

The California Power Exchange ("Power Exchange") has filed a claim with the State Victim Compensation and Government Claims Board (the "Board") seeking compensation from the State as a result of the commandeering by the Governor under Executive Orders of certain block forward power purchase contracts from Southern California Edison Company ("SCE") and Pacific Gas and Electric Company ("PG&E") in February 2001. The claim asserts the value of the SCE contracts to be approximately \$682.5 million and the value of the PG&E contracts to be approximately \$380.2 million for a total claim of approximately \$1.0627 billion. The State disputes the amount of this claim. In addition, SCE and PG&E have filed claims with the Board seeking unspecified amounts of compensation in the form of damages resulting from the commandeering of the block forward contracts. The Board has consolidated the briefing and hearing of these three claims.

On May 17, 2001, the claim of the Power Exchange (which in early 2001 filed for voluntary protection under Chapter 11 of the federal Bankruptcy Code) was assigned in the Power Exchange bankruptcy proceeding to the Participants' Committee, made up of the approximately 70 market participants. A group claim on behalf of the Participants' Committee is to be filed with the Victim Compensation and Government Claims Board. The group claim will be consolidated with the other three claims (i.e., Power Exchange, PG&E and SCE) and will be presented at a June 22, 2001 Board meeting.

**The impact of an adverse decision in one or more of the following cases may affect power costs in California, including those borne by the California Department of Water Resources (the “Department” or “DWR”) Power Supply Program. For additional information relating to the Department’s Power Supply Program, see “Recent Developments Regarding Energy” above.**

**Actions Challenging the Governor’s Authority to Commandeer Block Forward Contracts and Seeking Equitable Relief**

In *Duke Energy Trading and Marketing v. Davis, et al.* (U.S. District Court, C.D. Cal.), the plaintiff challenges the Governor’s orders commandeering SCE and PG&E block forward market contracts held by the Power Exchange on the ground that the orders violated the Supremacy Clause and other constitutional provisions. Duke Energy seeks a temporary restraining order (“TRO”) and injunction barring the Governor from taking any action against Duke Energy under the authority of the Executive Orders and a declaration that Duke Energy has no obligation to deliver power under the block forward contracts. The hearing on the TRO, seeking an order restraining the California Independent Systems Operator (“ISO”) from requiring the energy producer to supply energy under the contracts, was taken off calendar. Pursuant to an interim settlement, Duke Energy delivered power to the Department through April 30, 2001. On April 30, 2001, the U.S. District Court granted Governor Davis’ motion to dismiss plaintiff’s complaint based on Eleventh Amendment immunity and denied plaintiff’s motions for partial summary judgment to certify final judgment. On May 4, 2001, Duke Energy dismissed its claims in the District Court against co-defendant, the Power Exchange without prejudice and filed its notice of appeal to the Ninth Circuit Court of Appeal, with a motion that the briefing schedule and hearing on the appeal be expedited. On May 8, 2001, the State opposed the motion on the grounds that Duke Energy had not shown irreparable harm and requested dismissal of the appeal for lack of jurisdiction, as the orders appealed from were not final, appealable orders. The Ninth Circuit Court of Appeal denied the State’s motion to dismiss without prejudice to raising the issues in its brief on the merits, ordered an expedited briefing schedule, and set the matter for oral argument in mid-August.

*Tucson Electric v. Davis and California Power Exchange* is a matter pending before Federal Energy Regulatory Commission (“FERC”) in which Tucson Electric is challenging the Governor’s commandeering of the block forward contracts. The State has filed an answer asserting, *inter alia*, that FERC has no jurisdiction over the Governor. The California Power Exchange has asserted that the matter is stayed by the Power Exchange bankruptcy.

**Actions Contesting the ISO’s Authority to Continue to Order Power for PG&E and SCE**

In *California Independent Systems Operator v. Reliant Energy Services et. al.* (U.S. District Court, E.D. Cal), the ISO sued Reliant Energy (“Reliant”) and three other energy producers (Williams, AES, and Dynegy) because they were threatening to no longer comply with an ISO tariff that required them to supply energy when requested by ISO during a “System Emergency.” The ISO filed an application for a TRO and preliminary injunction. The State of

California acting through its Electricity Oversight Board intervened in the action in support of the ISO. On February 7, 2001, the District Court issued a TRO preventing the energy producers from refusing to supply power under the ISO tariff, even if they were not paid for the power ordered by SCE and PG&E. Pursuant to a stipulation among the parties, the TRO was dissolved and the four generators agreed to continue supplying power to the ISO, subject to termination on 48 hours' notice in the event of a favorable ruling by FERC on an Amendment to the ISO tariff proposed by the generators which would address the issues in the lawsuit. However, as of March 19, 2001, Reliant refused to extend the stipulation and on March 21, 2001, the court granted the ISO's motion for preliminary injunction against Reliant and denied Reliant's motion to dismiss the ISO complaint. Reliant filed an emergency motion with the 9th Circuit Court of Appeals for a stay of the preliminary injunction pending appeal, requesting a decision by April 4, 2001.

On April 5, 2001, the Court of Appeals granted the motion staying the preliminary injunction based primarily on the assertions of FERC jurisdiction. On April 6, 2001, the FERC issued an order rejecting the ISO's position that a tariff authorizing energy producers to refuse to supply power pursuant to ISO dispatch orders where the purchaser could not demonstrate creditworthiness, did not apply to emergency power and expressly found that the creditworthy criterion applied to all power purchases. Since these rulings, some power producers have indicated their unwillingness to provide emergency power pursuant to ISO dispatch orders unless payment is guaranteed by a creditworthy purchaser such as the State.

In the same action, Reliant has filed a third-party complaint against the Department seeking a declaration that AB 1X should be read to require the Department to pay for all power delivered to the ISO by energy producers, regardless of the price. Reliant Energy has filed a motion for TRO to include the Department based on the third-party complaint. On March 21, 2001, the District Court granted the Department's motion to dismiss Reliant's third-party complaint based on the Eleventh Amendment immunity. Reliant's appeal to the Ninth Circuit was dismissed by stipulation and motion. The underlying District Court case is currently "on hold" pending further FERC proceedings.

In *Duke Energy Trading and Marketing v. California Independent Systems Operator et al.* (U.S. District Court C.D. Cal), filed February 14, 2001, plaintiff alleges that the ISO/DWR are continuing to buy power for SCE and PG&E even though the utilities do not meet the creditworthiness requirements of the ISO tariff and that this constitutes a "taking" of property in violation of the 5th and 14th amendments to the United States Constitution. Duke Energy seeks declaratory relief and injunctive relief. Pursuant to stipulation, the action is stayed and Duke Energy is required to continue to supply power pursuant to ISO orders. On April 30, 2001, the District Court denied the ISO's motion to transfer venue to the Eastern District. Responsive pleadings are due June 25, 2001.

See also the discussion below under "Pacific Gas and Electric Bankruptcy and Related Adversary Proceedings" relating to the adversarial proceeding filed against the ISO by PG&E.

## **Actions By Qualified Facilities for Relief From Long-Term Power Supply Contracts with SCE and PG&E**

In *Luz Solar Partners, Ltd. v. Southern California Edison Company* (Sacramento County Superior Court), and similar actions around the State, plaintiff, an independent power generator (a "Qualifying Facility" or "QF"), applied for a temporary restraining order and preliminary injunction, suspending or terminating its contract with SCE to supply electricity, thereby allowing Luz Solar to sell that power in the open market at substantially higher prices. On May 21, 2001, the Attorney General filed an *amicus curiae* statement in support of SCE's opposition to Luz Solar. The application for a temporary restraining order was denied on May 29, 2001, and the hearing on plaintiff's motion for preliminary injunction is set for June 14, 2001.

See also the discussion below under "Pacific Gas and Electric Bankruptcy and Related Adversary Proceedings" relating to motions filed by Qualified Facilities seeking approval for suspension of their long-term power supply contracts with the debtor.

### **Pacific Gas and Electric Bankruptcy and Related Adversary Proceedings**

On April 6, 2001, PG&E filed a voluntary Chapter 11 bankruptcy petition in U.S. Bankruptcy Court for the Northern District of California in San Francisco (*In re Pacific Gas and Electric*, U.S. Bankruptcy Court, N.D. Cal.). The State has 180 days from April 6, 2001 to assess claims it may have as a creditor of PG&E, including but not limited to, income and property taxes, regulatory fees, fines or penalties and environmental claims.

On April 9, 2001, PG&E filed an adversary proceeding in the bankruptcy court seeking declaratory and injunctive relief against the California Public Utilities Commission and its current Commissioners in their respective capacity (collectively "CPUC") to prevent the CPUC from implementing or enforcing any order that requires PG&E to transfer any under-collection in its Transition Revenue Account to its Transition Cost Balancing Account on the grounds that such orders are illegal, improper and automatically stayed pursuant to provisions of the federal Bankruptcy Code. The CPUC filed an opposition brief asserting sovereign immunity, that the automatic stay does not apply, that if the automatic stay does apply the police and regulatory power exception applies, that PG&E must comply with State law in bankruptcy, and that the federal Bankruptcy Code does not authorize the court to grant the relief requested. On June 1, 2001, the bankruptcy judge denied PG&E's motion for preliminary injunction based upon the CPUC's assertion of sovereign immunity and granted the CPUC's motion for summary judgment.

PG&E has also filed an adversarial proceeding against the ISO to enjoin it from ordering power on PG&E's behalf unless the Department has agreed to pay for the power. This matter was heard on June 5, 2001. At the hearing, the parties agreed to work on a stipulation to a preliminary injunction that essentially requires the ISO to comply with the FERC orders (i.e. not to purchase power on behalf of a party that is not creditworthy or does not have a creditworthy backer). If the parties cannot agree by June 11, 2001, the court will treat the matter as submitted. Reliant Energy Services moved to intervene in the proceedings claiming it is suffering harm

because it is providing the power that the ISO is sending to PG&E despite PG&E's lack of creditworthiness, allegedly in contravention of FERC's orders. The court denied Reliant's request to appear as "*amicus*" at the hearing on PG&E's request for a preliminary injunction against the ISO. The court gave Reliant until June 11, 2001 to file a reply to the ISO's opposition to its motion to intervene in the adversary proceeding. The court granted the Official Committee of Unsecured Creditors' motion to intervene in this adversary action.

More than twenty Qualified Facilities have filed motions seeking relief from the automatic stay to allow them to suspend their contracts with PG&E or, in the alternative, seeking to compel PG&E to assume or reject their (executory) power contracts immediately. Two QFs, Mid-Set Cogeneration Co. and Oildale Group, claimed extreme financial hardship from having to provide power to PG&E without getting paid. On June 1, 2001, the court ruled on the QFs' motions: (1) denying the QFs' motions for relief from stay and their request to set a deadline for PG&E to assume or reject the contracts and (2) setting June 29 as a deadline for PG&E to file a statement supported by specific reasons as to when it will be in a position to assume or reject the contracts of all the QFs that now have motions on file. The court indicated that it would follow a similar procedure for QFs that do not have motions on file. However, the court provided some financial relief to those QFs who could demonstrate extreme financial hardship by ordering PG&E to either make adequate protection payments, in accordance with a formula, starting June 17, 2001 to Mid-set and Oildale so long as they are delivering electricity to PG&E, or allow the QF to suspend performance (under conditions established by the court).

#### **Action Challenging the Validity of Senate Bill 7X**

In *Hendricks v. Hannigan*, (San Diego Superior Court), plaintiff challenged implementation of Senate Bill 7X by the Director of the DWR on the ground that it provided for a gift of public funds. Senate Bill 7X authorized the DWR, for a period not to exceed 12 days from January 19, 2001, to purchase electric power from any party and to make that electric power available, at cost, to the ISO, public utility corporations or retail end-use customers. The purchases were to be funded from \$400,000,000 transferred from the General Fund to a newly-established Department of Water Resources Electric Power Fund. Defendant's demurrer was sustained without leave to amend and the complaint was dismissed. Plaintiff filed a notice of appeal on January 29, 2001.

#### **STATE DEBT TABLES**

The tables which follow provide information on outstanding State debt, authorized but unissued general obligation bonds and commercial paper notes, debt service requirements for State general obligation and lease-purchase bonds, and authorized and outstanding State revenue bonds. For purposes of these tables, "General Fund bonds," also known as "non-self liquidating bonds," are general obligation bonds expected to be paid from the General Fund without reimbursement from any other fund. Although the principal of general obligation commercial paper notes in the "non-self liquidating" category is legally payable from the General Fund, the State expects that principal of such commercial paper notes will be paid only from the issuance of new commercial paper notes or the issuance of long-term general obligation bonds to retire the

commercial paper notes. Interest on “non-self liquidating” general obligation commercial paper notes is payable from the General Fund.

“Enterprise Fund bonds,” also known as “self liquidating bonds,” are general obligation bonds for which program revenues are expected to be sufficient to reimburse in full the General Fund for debt service payments, but any failure to make such a reimbursement does not affect the obligation of the State to pay principal and interest on the bonds from the General Fund.

As of May 23, 2001, the total amount of General Obligation Commercial Paper Notes outstanding was \$974,945,000.



# AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

As of May 1, 2001  
(Thousands)

	<u>Voter Authorization</u>		<u>Bonds</u>	<u>CP Program</u>	<u>Unissued (b)</u>
	<u>Date</u>	<u>Amount</u>	<u>Outstanding</u>	<u>Authorized (a)</u>	
<b>GENERAL FUND BONDS (Non-Self Liquidating)</b>					
California Earthquake Safety and Housing Rehabilitation Bond Act of 1988.....	6/7/88	\$ 150,000	\$ 95,505	\$ n.a.	\$ 0
California Library Construction and Renovation Bond Act of 1988.....	11/8/88	75,000	49,065	1,225	1,900
California Library Construction and Renovation Bond Act of 2000.....	3/7/00	350,000	0	1,400	348,600
California Park and Recreational Facilities Act of 1984.....	6/5/84	370,000	168,480	n.a.	1,100
California Parklands Act of 1980.....	11/4/80	285,000	49,115	n.a.	0
California Safe Drinking Water Bond Law of 1976.....	6/8/76	175,000	54,440	n.a.	2,500
California Safe Drinking Water Bond Law of 1984.....	11/6/84	75,000	32,650	n.a.	0
California Safe Drinking Water Bond Law of 1986.....	11/4/86	100,000	68,210	n.a.	0
California Safe Drinking Water Bond Law of 1988.....	11/8/88	75,000	49,691	6,265	2,000
California Wildlife, Coastal, and Park Land Conservation Act of 1988.....	6/7/88	776,000	473,915	n.a.	14,980
Class Size Reduction Public Education Facilities Bond Act of 1998 (Hi Ed).....	11/3/98	2,500,000	358,030	346,000	1,793,000
Class Size Reduction Public Education Facilities Bond Act of 1998 (K-12).....	11/3/98	6,700,000	4,072,275	2,557,300	0
Clean Air and Transportation Improvement Bond Act of 1990.....	6/5/90	1,990,000	1,164,950	149,925	315,300
Clean Water and Water Conservation Bond Law of 1978.....	6/6/78	375,000	57,955	n.a.	0
Clean Water and Water Reclamation Bond Law of 1988.....	11/8/88	65,000	47,015	0	0
Clean Water Bond Law of 1970.....	11/3/70	250,000	5,000	n.a.	0
Clean Water Bond Law of 1974.....	6/4/74	250,000	10,230	n.a.	0
Clean Water Bond Law of 1984.....	11/6/84	325,000	100,825	n.a.	0
Community Parklands Act of 1986.....	6/3/86	100,000	50,920	n.a.	0
County Correctional Facility Capital Expenditure and Youth Facility Bond Act of 1988.....	11/8/88	500,000	314,195	0	0
County Correctional Facility Capital Expenditure Bond Act of 1986.....	6/3/86	495,000	256,885	n.a.	0
County Jail Capital Expenditure Bond Act of 1981.....	11/2/82	280,000	87,600	n.a.	0
County Jail Capital Expenditure Bond Act of 1984.....	6/5/84	250,000	76,150	n.a.	0
Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990.....	6/5/90	300,000	121,255	155,000	0
Fish and Wildlife Habitat Enhancement Act of 1984.....	6/5/84	85,000	33,870	n.a.	3,000
Hazardous Substance Cleanup Bond Act of 1984.....	11/6/84	100,000	37,085	n.a.	0
Higher Education Facilities Bond Act of 1986.....	11/4/86	400,000	173,150	n.a.	0
Higher Education Facilities Bond Act of 1988.....	11/8/88	600,000	299,105	4,705	7,000
Higher Education Facilities Bond Act of June 1990.....	6/5/90	450,000	255,915	7,000	1,000
Higher Education Facilities Bond Act of June 1992.....	6/2/92	900,000	663,485	17,410	8,700
Housing and Homeless Bond Act of 1988.....	11/8/88	300,000	111,705	n.a.	0
Housing and Homeless Bond Act of 1990.....	6/5/90	150,000	78,365	n.a.	0
Lake Tahoe Acquisitions Bond Act.....	8/2/82	85,000	36,755	n.a.	0

# **AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS** (Continued)

	<u>Voter Authorization</u>		<u>Bonds</u>		<u>CP Program</u>	<u>Unissued (b)</u>
	<u>Date</u>	<u>Amount</u>	<u>Outstanding</u>	<u>Authorized (a)</u>		
New Prison Construction Bond Act of 1981.....	6/8/82	\$ 495,000	\$ 93,750	\$ n.a.	\$	0
New Prison Construction Bond Act of 1984.....	6/5/84	300,000	67,500	n.a.		0
New Prison Construction Bond Act of 1986.....	11/4/86	500,000	229,920	n.a.		1,500
New Prison Construction Bond Act of 1988.....	11/8/88	817,000	410,685	7,600		8,400
New Prison Construction Bond Act of 1990.....	6/5/90	450,000	248,555	16,100		4,000
Passenger Rail and Clean Air Bond Act of 1990.....	6/5/90	1,000,000	604,410	24,900		0
Public Education Facilities Bond Act of 1996.....	3/26/96	3,000,000	2,529,660	211,485		8,700
1988 School Facilities Bond Act.....	11/8/88	800,000	429,475	7,000		0
1990 School Facilities Bond Act.....	6/5/90	800,000	452,955	3,745		0
1992 School Facilities Bond Act.....	11/3/92	900,000	628,998	12,594		0
Safe, Clean Reliable Water Supply Act of 1996.....	11/5/96	995,000	275,065	194,200		511,800
Safe Drinking Water Bond Act of 2000.....	3/7/00	1,970,000	0	324,200		1,645,800
Safe Neighborhood Parks Bond Act of 2000.....	3/7/00	2,100,000	80,000	264,000		1,756,000
School Building and Earthquake Bond Act of 1974.....	11/5/74	40,000	34,660	n.a.		0
School Facilities Bond Act of 1988.....	6/7/88	800,000	384,995	n.a.		0
School Facilities Bond Act of 1990.....	11/6/90	800,000	478,840	6,500		0
School Facilities Bond Act of 1992.....	6/2/92	1,900,000	1,227,690	47,400		0
Seismic Retrofit Bond Act of 1996.....	3/26/96	2,000,000	1,147,540	317,645		448,000
Senior Center Bond Act of 1984.....	11/6/84	50,000	14,750	n.a.		0
State Beach, Park, Recreational and Historical Facilities Bonds.....	6/4/74	250,000	1,735	n.a.		0
State School Building Lease-Purchase Bond Law of 1982.....	11/2/82	500,000	72,175	n.a.		0
State School Building Lease-Purchase Bond Law of 1984.....	11/6/84	450,000	165,250	n.a.		0
State School Building Lease-Purchase Bond Law of 1986.....	11/4/86	800,000	370,900	n.a.		0
State, Urban, and Coastal Park Bond Act of 1976.....	11/2/76	280,000	19,265	n.a.		0
Veterans' Homes Bond Act of 2000.....	3/7/00	50,000	0	0		50,000
Water Conservation and Water Quality Bond Law of 1986.....	6/3/86	150,000	75,250	n.a.		31,000
Water Conservation Bond Law of 1988.....	11/8/88	60,000	33,390	13,435		3,000
<b>Total General Fund Bonds.....</b>		<b>\$ 42,138,000</b>	<b>\$ 19,531,203</b>	<b>\$ 4,697,034</b>		<b>\$ 6,967,280</b>
<b>ENTERPRISE FUND BONDS (Self Liquidating)</b>						
California Water Resources Development Bond Act of 1959.....	11/8/60	\$ 1,750,000	\$ 910,020	\$ n.a.	\$	\$ 167,600
Veterans Bonds.....	(c)	5,510,000	2,448,795	0		147,585
<b>Total Enterprise Fund Bonds.....</b>		<b>\$ 7,260,000</b>	<b>\$ 3,358,815</b>	<b>\$ 0</b>		<b>\$ 315,185</b>
<b>TOTAL GENERAL OBLIGATION BONDS.....</b>		<b>\$ 49,398,000</b>	<b>\$ 22,890,018</b>	<b>\$ 4,697,034</b>		<b>\$ 7,282,465</b>

(a) Total commercial paper authorized to be issued by the respective Finance Committees. Of this total \$802,945,000 is outstanding as of May 1, 2001.

Pursuant to terms of the Finance Committee resolutions, no more than \$1.5 billion of commercial paper can be outstanding at any one time.

Bond acts marked "n.a." are not legally permitted to utilize commercial paper, or all bonds were issued before the commercial paper program began.

(b) Treats full commercial paper authorization as issued; see footnote (a).

(c) Various dates.

SOURCE: State of California, Office of the Treasurer.

**OUTSTANDING STATE DEBT**  
**FISCAL YEARS 1995-96 THROUGH 1999-00**  
(Dollars in Thousands Except for Per Capita Information)

	<u>1995-96</u>	<u>1996-97</u>	<u>1997-98</u>	<u>1998-99</u>	<u>1999-00</u>
<b>Outstanding Debt(a)</b>					
General Obligation Bonds					
General Fund (Non-Self Liquidating).....	\$ 14,322,086	\$ 14,250,536	\$ 14,932,766	\$ 16,202,211	\$ 17,869,616
Enterprise Fund (Self Liquidating).....	3,934,630	3,699,060	3,906,950	3,674,020	3,472,300
Total.....	\$ 18,256,716	\$ 17,949,596	\$ 18,839,716	\$ 19,876,231	\$ 21,341,916
Lease-Purchase Debt.....	5,812,237	6,175,044	6,639,620	6,671,534	6,627,944
Total Outstanding General Obligation Bonds and Lease-Purchase Debt.....	\$ 24,101,953	\$ 24,124,640	\$ 25,479,336	\$ 26,547,765	\$ 27,969,860
<b>Bond Sales During Fiscal Year</b>					
Non-Self Liquidating General Obligation Bonds.....	\$ 620,810	\$ 1,025,000	\$ 1,667,820	\$ 2,294,650	\$ 2,750,000
Self Liquidating General Obligation Bonds.....	\$ 0	\$ 0	\$ 447,535	\$ 80,000	\$ 126,500
Lease-Purchase Debt.....	\$ 779,575	\$ 1,257,630	\$ 1,245,190	\$ 456,410	\$ 293,235
<b>Debt Service(b)</b>					
Non-Self Liquidating General Obligation Bonds.....	\$ 1,960,603	\$ 1,946,333	\$ 1,878,026	\$ 1,934,628	\$ 2,045,566
Lease-Purchase Debt.....	\$ 481,751	\$ 532,783	\$ 577,987	\$ 652,131	\$ 654,485
<b>General Fund Receipts(b)</b> .....	\$ 46,731,104	\$ 49,831,217	\$ 55,261,557	\$ 58,510,860	\$ 72,226,473
Non-Self Liquidating General Obligation Bonds					
Debt Service as a Percentage of General Fund Receipts.....	4.20%	3.91%	3.40%	3.31%	2.83%
Lease-Purchase Debt Service as a Percentage of General Fund Receipts.....	1.03%	1.07%	1.05%	1.11%	0.91%
<b>Population(c)</b> .....	32,063,000	32,383,000	32,957,000	33,494,000	34,036,000
Non-Self Liquidating General Obligation Bonds					
Outstanding Per Capita.....	\$ 446.69	\$ 440.06	\$ 453.10	\$ 483.73	\$ 525.02
Lease-Purchase Debt Outstanding Per Capita.....	\$ 182.30	\$ 190.69	\$ 201.46	\$ 199.19	\$ 194.73
<b>Personal Income(d)</b> .....	\$ 812,404,210	\$ 862,755,817	\$ 920,452,229	\$ 989,706,630	\$ 1,063,000,000
Non-Self Liquidating General Obligation Bonds					
Outstanding as Percentage of Personal Income.....	1.76%	1.65%	1.62%	1.64%	1.68%
Lease-Purchase Debt Outstanding as Percentage of Personal Income.....	0.72%	0.72%	0.72%	0.67%	0.62%

(a) As of last day of fiscal year

(b) Calculated on a cash basis; debt service costs of bonds issued in any fiscal year largely appear in subsequent fiscal year.

(c) As of July 1, the beginning of the fiscal year.

(d) Calendar year in which fiscal year ends: 1999 estimated; 2000 consistent with May Revision.

SOURCES: Population: State of California, Department of Finance

Personal Income: State of California, Department of Finance; United States, Department of Commerce

Outstanding Debt, Bonds Sales During Fiscal Year and Debt Service: State of California, Office of the Treasurer.

General Fund Receipts: State of California, Office of the State Controller.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS  
FOR GENERAL FUND GENERAL OBLIGATION BONDS(a)  
(Non-Self Liquidating)  
As of May 1, 2001**

Fiscal Year Ending <u>June 30</u>	Current Debt		
	<u>Interest</u>	<u>Principal (b)</u>	<u>Total</u>
2001.....	\$ 67,310,718.40	\$ 58,310,000.00	\$ 125,620,718.40 (c)
2002.....	1,094,800,921.32	1,371,285,000.00	2,466,085,921.32
2003.....	1,009,399,363.89	1,320,506,391.80	2,329,905,755.69
2004.....	922,513,246.70	1,246,500,000.00	2,169,013,246.70
2005.....	848,332,822.59	1,159,809,388.71	2,008,142,211.30
2006.....	778,352,275.00	1,089,190,000.00	1,867,542,275.00
2007.....	713,405,678.43	1,058,975,000.00	1,772,380,678.43
2008.....	654,641,042.93	1,028,888,078.31	1,683,529,121.24
2009.....	593,976,268.75	1,020,175,000.00	1,614,151,268.75
2010.....	533,745,868.06	964,495,000.00	1,498,240,868.06
2011.....	480,004,248.59	877,954,045.16	1,357,958,293.75
2012.....	426,785,300.05	634,495,000.00	1,061,280,300.05
2013.....	392,156,251.25	553,425,000.00	945,581,251.25
2014.....	364,842,705.89	445,640,000.00	810,482,705.89
2015.....	342,543,819.69	473,840,000.00	816,383,819.69
2016.....	317,631,713.96	452,060,000.00	769,691,713.96
2017.....	292,953,594.60	474,755,000.00	767,708,594.60
2018.....	268,330,100.98	477,620,000.00	745,950,100.98
2019.....	243,490,381.00	476,585,000.00	720,075,381.00
2020.....	218,734,593.50	472,885,000.00	691,619,593.50
2021.....	195,066,919.75	471,560,000.00	666,626,919.75
2022.....	170,505,253.50	496,790,000.00	667,295,253.50
2023.....	143,947,592.70	499,110,000.00	643,057,592.70
2024.....	119,328,627.84	429,370,000.00	548,698,627.84
2025.....	97,506,019.08	390,020,000.00	487,526,019.08
2026.....	77,432,085.09	352,240,000.00	429,672,085.09
2027.....	58,999,585.09	335,600,000.00	394,599,585.09
2028.....	41,905,801.59	318,100,000.00	360,005,801.59
2029.....	26,563,575.00	266,895,000.00	293,458,575.00
2030.....	13,275,180.75	207,625,000.00	220,900,180.75
2031.....	3,513,927.00	106,500,000.00	110,013,927.00
Total .....	<u>\$ 11,511,995,482.97</u>	<u>\$ 19,531,202,903.98</u>	<u>\$ 31,043,198,386.95</u>

(a) Does not include commercial paper outstanding.

(b) Includes scheduled mandatory sinking fund payments as well as serial maturities.

(c) Total represents the remaining debt service requirements from June 1, 2001 through June 30, 2001.

SOURCE: State of California, Office of the Treasurer.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS  
FOR ENTERPRISE FUND GENERAL OBLIGATION BONDS(a)  
(Self Liquidating)  
As of May 1, 2001**

<b>Fiscal Year Ending June 30</b>	<b>Current Debt</b>		
	<b>Interest</b>	<b>Principal (b)</b>	<b>Total</b>
2001.....	\$ 43,724,770.87	\$ 4,600,000.00	\$ 48,324,770.87 (c)
2002.....	196,795,383.77	117,975,000.00	314,770,383.77
2003.....	187,197,507.60	118,125,000.00	305,322,507.60
2004.....	178,029,870.00	141,390,000.00	319,419,870.00
2005.....	168,150,233.50	154,240,000.00	322,390,233.50
2006.....	157,718,118.50	152,355,000.00	310,073,118.50
2007.....	146,438,574.76	183,445,000.00	329,883,574.76
2008.....	133,950,622.29	187,805,000.00	321,755,622.29
2009.....	121,866,396.25	178,625,000.00	300,491,396.25
2010.....	110,284,181.55	168,595,000.00	278,879,181.55
2011.....	100,713,135.77	125,895,000.00	226,608,135.77
2012.....	93,246,658.50	168,810,000.00	262,056,658.50
2013.....	84,950,670.62	169,935,000.00	254,885,670.62
2014.....	77,587,982.25	136,470,000.00	214,057,982.25
2015.....	71,480,503.15	135,730,000.00	207,210,503.15
2016.....	64,518,767.00	141,505,000.00	206,023,767.00
2017.....	57,082,598.14	133,290,000.00	190,372,598.14
2018.....	50,788,979.09	113,615,000.00	164,403,979.09
2019.....	45,348,599.21	110,025,000.00	155,373,599.21
2020.....	40,250,731.80	75,735,000.00	115,985,731.80
2021.....	35,923,257.54	70,410,000.00	106,333,257.54
2022.....	31,823,176.14	67,470,000.00	99,293,176.14
2023.....	27,811,041.89	49,490,000.00	77,301,041.89
2024.....	24,933,835.64	52,400,000.00	77,333,835.64
2025.....	21,888,397.50	55,420,000.00	77,308,397.50
2026.....	18,657,110.00	83,205,000.00	101,862,110.00
2027.....	14,211,473.75	68,520,000.00	82,731,473.75
2028.....	10,240,730.00	29,250,000.00	39,490,730.00
2029.....	8,379,846.25	36,275,000.00	44,654,846.25
2030.....	6,426,395.00	32,575,000.00	39,001,395.00
2031.....	4,632,940.00	30,125,000.00	34,757,940.00
2032.....	2,851,467.50	31,840,000.00	34,691,467.50
2033.....	968,033.75	33,670,000.00	34,638,033.75
<b>Total .....</b>	<b>\$ 2,338,871,989.58</b>	<b>\$ 3,358,810,000.00</b>	<b>\$ 5,697,686,989.58</b>

(a) Does not include commercial paper outstanding.

(b) Includes scheduled mandatory sinking fund payments as well as serial maturities.

(c) Total represents the remaining debt service requirements from June 1, 2001 through June 30, 2001.

SOURCE: State of California, Office of the Treasurer.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS  
FOR LEASE-PURCHASE DEBT  
As of May 1, 2001**

Fiscal Year Ending <u>June 30</u>	Current Debt		
	<u>Interest</u>	<u>Principal (a)</u>	<u>Total</u>
2001.....	\$ 72,388,469.47	25,500,000.00	\$ 97,888,469.47 (b)
2002.....	340,083,413.55	300,430,773.02	640,514,186.57
2003.....	328,353,831.76	305,746,118.58	634,099,950.34
2004.....	312,467,474.47	313,846,386.24	626,313,860.71
2005.....	297,868,984.05	327,844,507.20	625,713,491.25
2006.....	278,662,190.93	346,882,554.60	625,544,745.53
2007.....	265,854,480.09	299,063,920.44	564,918,400.53
2008.....	247,569,233.60	306,366,787.98	553,936,021.58
2009.....	235,640,243.18	327,507,732.44	563,147,975.62
2010.....	213,032,047.34	315,131,633.76	528,163,681.10
2011.....	185,285,977.24	326,715,000.00	512,000,977.24
2012.....	167,927,108.81	308,870,000.00	476,797,108.81
2013.....	151,492,084.95	316,275,000.00	467,767,084.95
2014.....	134,779,824.73	317,805,000.00	452,584,824.73
2015.....	117,529,875.98	334,735,000.00	452,264,875.98
2016.....	99,582,410.94	314,270,000.00	413,852,410.94
2017.....	82,362,000.71	317,335,000.00	399,697,000.71
2018.....	65,527,503.09	329,845,000.00	395,372,503.09
2019.....	48,502,722.79	286,345,000.00	334,847,722.79
2020.....	33,504,462.45	254,110,000.00	287,614,462.45
2021.....	21,615,555.38	185,190,000.00	206,805,555.38
2022.....	11,956,658.73	152,615,000.00	164,571,658.73
2023.....	5,634,088.15	95,055,000.00	100,689,088.15
2024.....	1,404,390.63	15,155,000.00	16,559,390.63
2025.....	478,230.00	16,120,000.00	16,598,230.00
Total .....	<u>\$ 3,719,503,263.02</u>	<u>\$ 6,438,760,414.26</u>	<u>\$ 10,158,263,677.28</u>

(a) Includes scheduled mandatory sinking fund payments as well as serial maturities.

(b) Total represents the remaining debt service requirements from June 1, 2001 through June 30, 2001.

SOURCE: State of California, Office of the Treasurer.

**THE PUBLIC WORKS BOARD AND  
OTHER LEASE-PURCHASE FINANCING  
OUTSTANDING ISSUES**

**May 1, 2001**

<u><b>Name of Issue</b></u>	<u><b>Outstanding</b></u>
<u><b>GENERAL FUND SUPPORTED ISSUES:</b></u>	
<b>State Public Works Board</b>	
California Community Colleges .....	\$ 604,500,000
Department of the Youth Authority .....	8,785,000
Department of Corrections * .....	2,488,295,739
Energy Efficiency Program (Various State Agencies) (a) .....	107,960,000
The Regents of The University of California * (b) .....	1,050,399,675
Trustees of The California State University .....	674,950,000
Various State Office Buildings .....	548,730,000
<b>Total State Public Works Board Issues .....</b>	<b>\$ 5,483,620,414</b>
<b>Total Other State Building Lease Purchase Issues (c) .....</b>	<b>\$ 955,140,000</b>
<b>Total General Fund Supported Issues .....</b>	<b>\$ 6,438,760,414</b>
<u><b>SPECIAL FUND SUPPORTED ISSUES:</b></u>	
East Bay State Building Authority Certificates of Participation (State of California Department of Transportation) * .....	\$ 75,258,050
San Bernardino Joint Powers Financing Authority (State of California Department of Transportation) .....	58,950,000
San Francisco State Building Authority (State of California Department of General Services Lease) (d) .....	47,005,000
<b>Total Special Fund Supported Issues .....</b>	<b>\$ 181,213,050</b>
<b>TOTAL .....</b>	<b>\$ 6,619,973,464</b>

\* Includes the initial value of capital appreciation bonds rather than the accreted value.

(a) This program is self-liquidating based on energy cost savings.

(b) The Regents' obligations to the State Public Works Board are payable from lawfully available funds of The Regents which are held in The Regents' treasury funds and are separate from the State General Fund. A portion of The Regents' annual budget is derived from General Fund appropriations.

(c) Includes \$191,435,000 Sacramento City Financing Authority Lease Revenue Bonds State of California - Cal EPA Building, 1998 Series A, which are supported by lease rentals from the California Environmental Protection Agency; these rental payments are subject to annual appropriation by the State Legislature.

(d) The sole tenant is the California Public Utilities Commission.

SOURCE: State of California, Office of the Treasurer.

**STATE AGENCY REVENUE BONDS  
AND CONDUIT FINANCING  
As of December 31, 2000**

<b><u>Issuing Agency</u></b>	<b><u>Outstanding<sup>(a)</sup></u></b>
<b><u>State Programs Financing:</u></b>	
California State University.....	\$ 518,498,000
California Transportation Commission.....	--
Department of Water Resources.....	2,407,705,000
The Regents of the University of California.....	3,412,220,000
Trade and Commerce Agency.....	--
<b><u>Housing Financing:</u></b>	
California Housing Finance Agency.....	7,286,531,811
Veterans Revenue Debenture.....	538,435,000
<b><u>Conduit Financing:</u></b>	
California Alternative Energy and Advanced Transportation Financing Authority.....	59,385,000
California Educational Facilities Authority.....	2,358,841,416
California Health Facilities Financing Authority.....	6,290,383,925
California Infrastructure and Economic Development Bank <sup>(b) (c)</sup> .....	789,849,717
California Passenger Rail Financing Commission.....	--
California Pollution Control Financing Authority.....	4,957,081,641
California School Finance Authority.....	170,000
California Student Loan Authority.....	55,260,000
California Urban Waterfront Area Restoration Financing Authority.....	-
<b>TOTAL.....</b>	<b><u>\$ 28,674,361,510</u></b>

<sup>(a)</sup> Total Outstanding does not include defeased bonds and includes the accreted values for capital appreciation bonds.

<sup>(b)</sup> Does not include \$6.0 billion of "rate reduction bonds" issued by special purpose trusts for the benefit of four investor-owned electric utility companies representing interests in certain electric rate surcharges.

<sup>(c)</sup> California Economic Development Financing Authority merged with California Infrastructure and Economic Development Bank effective January 1, 1999.

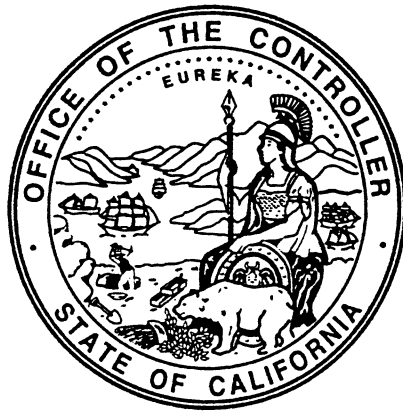
SOURCE: State of California, Office of the Treasurer.



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# **STATEMENT of GENERAL FUND CASH RECEIPTS and DISBURSEMENTS**

**December 2000**



**KATHLEEN CONNELL**  
California State Controller



KATHLEEN CONNELL  
Controller of the State of California

January 8, 2001

Users of the Statement of General Fund Cash Receipts and Disbursements

Attached is the Statement of General Fund Cash Receipts and Disbursements for the period July 1, 2000, through December 31, 2000. This statement reflects the State of California's General Fund cash position and compares actual receipts and disbursements for the 2000-01 fiscal year to cash flow estimates presented by the Department of Finance based upon the 2000-01 Budget Act. The statement is prepared in compliance with Government Code Section 12461.1, as well as Item 0840-001-0001, Provision 10, of the 2000-01 Budget Act, using records compiled by the State Controller. Prior year actual amounts are also displayed for comparative purposes.

These statements are also available on the Internet at the State Controller's home page at [www.sco.ca.gov](http://www.sco.ca.gov), under the category Statements of General Fund Cash Receipts and Disbursements.

Any questions concerning this report may be directed to Walter Barnes, Chief Deputy State Controller, Finance at (916) 445-7447.

Sincerely,

A handwritten signature in black ink, which appears to read "Kathleen Connell". The signature is fluid and cursive.

KATHLEEN CONNELL  
State Controller

**STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS**  
**A Comparison of Actual to 2000-01 Budget Act Estimates**  
**(Amounts in thousands)**

	July 1 through December 31				
	2000				1999
	Actual	Estimate (a)	Actual Over or (Under) Estimate		Actual
			Amount	%	
GENERAL FUND BEGINNING CASH BALANCE	\$ 8,531,322	\$ 8,531,322	\$ -	-	\$ 847,936
Add Receipts:					
Revenues	32,675,546	31,850,000	825,546	2.6	29,824,523
Nonrevenues	299,170	79,432	219,738	276.6	211,202
Total Receipts	32,974,716	31,929,432	1,045,284	3.3	30,035,725
Less Disbursements:					
State Operations	9,123,869	9,412,432	(288,563)	(3.1)	8,385,721
Local Assistance	28,058,026	31,508,622	(3,450,596)	(11.0)	23,887,767
Capital Outlay	702,799	2,012,676	(1,309,877)	(65.1)	71,976
Nongovernmental	(90,825)	102,480	(193,305)	(188.6)	344,103
Total Disbursements	37,793,869	43,036,210	(5,242,341)	(12.2)	32,689,567
Receipts Over / (Under) Disbursements	(4,819,153)	(11,106,778)	6,287,625	-	(2,653,842)
Net Increase / (Decrease) in Temporary Loans	-	2,575,456	(2,575,456)	(100.0)	1,805,906
GENERAL FUND ENDING CASH BALANCE	3,712,169	-	3,712,169	-	-
Special Fund for Economic Uncertainties (b)	815,641	-	815,641	-	454,711
TOTAL CASH	\$ 4,527,810	\$ -	\$ 4,527,810	-	\$ 454,711
BORROWABLE RESOURCES					
Available Borrowable Resources	\$ 10,018,949	\$ 10,182,458	\$ (163,509)	(1.6)	\$ 9,534,506
Outstanding Loans	-	2,575,456	(2,575,456)	(100.0)	1,805,906
Unused Borrowable Resources	\$ 10,018,949	\$ 7,607,002	\$ 2,411,947	31.7	\$ 7,728,600

General Note:

This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:

- (a) A Statement of Estimated Cash Flow for the 2000-01 fiscal year prepared by the Department of Finance for the Budget Act of 2000. Any projections or estimates are set forth as such and not as representations of fact.
- (b) Includes the Disaster Response-Emergency Operations Account within the Special Fund for Economic Uncertainties.
- (c) Negative balances are the result of repayments received that are greater than disbursements made.
- (d) Excludes State School Building Aid Bonds.

**SCHEDULE OF CASH RECEIPTS**

(Amounts in thousands)

	Month of December		July 1 through December 31				
			2000				1999
	2000	1999	Actual	Estimate (a)	Actual Over or (Under) Estimate		Actual
					Amount	%	
REVENUES							
Alcoholic Beverage Excise Tax	\$ 26,176	\$ 25,765	\$ 150,520	\$ 151,000	\$ (480)	(0.3)	\$ 147,173
Bank and Corporation Tax	964,695	958,990	3,057,121	3,117,000	(59,879)	(1.9)	2,869,479
Cigarette Tax	12,735	20,887	65,195	68,000	(2,805)	(4.1)	70,312
Horse Racing Fees	170	150	1,536	-	1,536	-	773
Estate, Inheritance, and Gift Tax	76,221	154,155	450,698	499,000	(48,302)	(9.7)	506,786
Insurance Companies Tax	303,339	300,601	645,263	639,000	6,263	1.0	621,118
Personal Income Tax	3,835,938	4,001,520	17,230,426	16,661,000	569,426	3.4	15,018,011
Retail Sales and Use Taxes	1,734,731	1,855,748	10,433,155	10,118,000	315,155	3.1	9,770,633
Pooled Money Investment Interest	57,001	15,068	373,553	172,000	201,553	117.2	149,755
Not Otherwise Classified	26,649	495,602	268,079	425,000	(156,921)	(36.9)	670,483
Total Revenues	7,037,655	7,828,486	32,675,546	31,850,000	825,546	2.6	29,824,523
NONREVENUES							
Transfers from Special Fund for Economic Uncertainties	-	-	440	-	440	-	-
Transfers from Other Funds	1,209	11,461	123,349	(51,073)	174,422	-	82,425
Miscellaneous	8,821	9,041	175,381	130,505	44,876	34.4	128,777
Total Nonrevenues	10,030	20,502	299,170	79,432	219,738	276.6	211,202
Total Receipts	\$ 7,047,685	\$ 7,848,988	\$ 32,974,716	\$ 31,929,432	\$ 1,045,284	3.3	\$ 30,035,725

See notes on page 1.

**SCHEDULE OF CASH DISBURSEMENTS**

(Amounts in thousands)

		July 1 through December 31					
Month of December		2000				1999	
2000	1999	Actual	Estimate (a)	Actual Over or (Under) Estimate		Actual	
				Amount	%		
STATE OPERATIONS (c)							
Legislative/Judicial/Executive	\$ 84,647	\$ 77,228	\$ 552,337	\$ 563,680	\$ (11,343)	(2.0)	\$ 531,396
State and Consumer Services	29,717	26,416	219,016	220,400	(1,384)	(0.6)	203,457
Business, Transportation and Housing	(1,466)	146	41,903	21,300	20,603	96.7	5,398
Trade and Commerce	1,992	2,648	28,409	26,330	2,079	7.9	17,445
Resources	74,601	74,197	448,459	522,760	(74,301)	(14.2)	425,670
Environmental Protection Agency	6,099	15,778	73,457	217,800	(144,343)	(66.3)	76,824
Health and Human Services:							
Health Services	44,666	34,012	165,166	238,230	(73,064)	(30.7)	164,929
Mental Health Hospitals	41,675	41,329	247,757	254,400	(6,643)	(2.6)	204,773
Other Health and Human Services	97,526	42,913	279,480	294,420	(14,940)	(5.1)	262,756
Education:							
University of California	269,083	276,747	1,549,694	1,681,830	(132,136)	(7.9)	1,418,772
State Universities and Colleges	167,133	179,546	1,167,429	1,295,910	(128,481)	(9.9)	1,163,949
Other Education	13,708	(1,810)	96,611	97,520	(909)	(0.9)	82,340
Corrections and Youth Authority	406,109	209,947	2,454,433	2,158,820	295,613	13.7	2,140,367
General Government	67,773	67,263	544,656	491,340	53,316	10.9	391,493
Public Employees Retirement System	(9,341)	(365)	(27,674)	(19,590)	(8,084)	-	132,748
Debt Service (d)	105,861	71,866	1,281,065	1,345,553	(64,488)	(4.8)	1,157,319
Interest on Loans	-	-	1,671	1,729	(58)	(3.4)	6,085
Total State Operations	1,399,783	1,117,861	9,123,869	9,412,432	(288,563)	(3.1)	8,385,721
LOCAL ASSISTANCE (c)							
Public Schools - K-12	2,026,621	1,716,604	11,652,654	13,227,360	(1,574,706)	(11.9)	10,409,224
Community Colleges	114,565	109,638	1,386,940	1,385,270	1,670	0.1	1,145,940
Contributions to State Teachers' Retirement System	-	-	725,500	725,501	(1)	-	677,236
Other Education	188,023	303,484	1,037,863	1,298,540	(260,677)	(20.1)	1,059,233
Corrections and Youth Authority	10,788	4,508	54,699	191,890	(137,191)	(71.5)	48,707
Dept. of Alcohol and Drug Program	64,629	22,044	106,005	71,830	34,175	47.6	51,348
Dept. of Health Services:							
Medical Assistance Program	712,355	824,324	4,025,077	4,745,670	(720,593)	(15.2)	4,207,607
Other Health Services	36,239	41,349	188,246	215,440	(27,194)	(12.6)	163,683
Dept. of Developmental Services	95,765	39,568	876,322	881,230	(4,908)	(0.6)	593,728
Dept. of Mental Health	148,007	(48,530)	181,507	325,460	(143,953)	(44.2)	195,692
Dept. of Social Services:							
SSI/SSP/IHSS	288,530	131,624	1,978,843	1,640,000	338,843	20.7	1,508,476
CalWORKs	143,915	125,616	1,994,934	1,930,192	64,742	3.4	1,705,385
Other Social Services	78,448	96,682	524,141	570,500	(46,359)	(8.1)	494,886
Tax Relief	297,002	172,409	1,365,412	1,130,734	234,678	20.8	299,550
School Facility Aid Program	-	-	20,733	17,000	3,733	22.0	25,736
Other Local Assistance	382,286	213,504	1,939,150	3,152,005	(1,212,855)	(38.5)	1,301,336
Total Local Assistance	4,587,173	3,752,824	28,058,026	31,508,622	(3,450,596)	(11.0)	23,887,767

See notes on page 1.

(Continued)

**SCHEDULE OF CASH DISBURSEMENTS (Continued)**  
 (Amounts in thousands)

	Month of December		July 1 through December 31				1999
	2000	1999	2000		Actual Over or (Under) Estimate		
			Actual	Estimate (a)	Amount	%	
CAPITAL OUTLAY	81,377	12,882	702,799	2,012,676	(1,309,877)	(65.1)	71,976
NON-GOVERNMENTAL (c)							
Transfer to Special Fund for Economic Uncertainties	-	-	-	-	-	-	(45)
Transfer to Other Funds	14,679	93,395	116,903	102,480	14,423	14.1	603,216
Transfer to Revolving Fund	5,456	19,275	89,326	-	89,326	-	53,538
Advance:							
State-County Property Tax Administration Program	2,208	19,741	12,881	-	12,881	-	30,733
Social Welfare Federal Fund	5,641	46,492	(33,778)	-	(33,778)	-	75,832
Tax Relief and Refund Account	2,500	3,100	2,500	-	2,500	-	33,200
Trial Court Trust Fund	-	-	-	-	-	-	(187,000)
Counties for Social Welfare	-	-	(278,657)	-	(278,657)	-	(265,371)
Total Nongovernmental	30,484	182,003	(90,825)	102,480	(193,305)	(188.6)	344,103
Total Disbursements	\$ 6,098,817	\$ 5,065,570	\$ 37,793,869	\$ 43,036,210	\$ (5,242,341)	(12.2)	\$ 32,689,567
TEMPORARY LOANS (d)							
Special Fund for Economic Uncertainties	\$ -	\$ (454,713)	\$ -	\$ 880,000	\$ (880,000)	(100.0)	\$ 805,906
Other Internal Sources	-	(2,328,705)	-	1,695,456	(1,695,456)	(100.0)	-
Revenue Anticipation Notes	-	-	-	-	-	-	1,000,000
Net Increase / (Decrease) Loans	\$ -	\$ (2,783,418)	\$ -	\$ 2,575,456	\$ (2,575,456)	(100.0)	\$ 1,805,906

See notes on page 1.

(Concluded)

**COMPARATIVE STATEMENT OF REVENUES RECEIVED**  
**All Governmental Cost Funds**  
**(Amounts in thousands)**

	July 1 through December 31			
	General Fund		Special Funds	
	2000	1999	2000	1999
<b>MAJOR TAXES, LICENSES, AND INVESTMENT INCOME:</b>				
Alcoholic Beverage Excise Taxes	\$ 150,520	\$ 147,173	\$ -	\$ -
Bank and Corporation Tax	3,057,121	2,869,479	20	36
Cigarette Tax	65,195	70,312	536,396	593,352
Estate, Inheritance, and Gift Tax	450,698	506,786	-	-
Horse Racing Fees	1,536	773	20,305	20,328
Insurance Companies Tax	645,263	621,118	-	-
Motor Vehicle Fuel Tax:				
Gasoline Tax	-	-	1,332,354	1,294,063
Diesel & Liquid Petroleum Gas	-	-	243,268	230,096
Jet Fuel Tax	-	-	1,160	1,096
Vehicle License Fees	-	-	1,616,839	1,682,340
Motor Vehicle Registration and Other Fees	-	-	951,894	923,527
Personal Income Tax	17,230,426	15,018,011	142	2
Retail Sales and Use Taxes	10,433,155	9,770,633	2,605,275	2,029,717
Pooled Money Investment Interest	373,553	149,755	152	272
<b>Total Major Taxes, Licenses, and Investment Income</b>	<b>32,407,467</b>	<b>29,154,040</b>	<b>7,307,805</b>	<b>6,774,829</b>
<b>NOT OTHERWISE CLASSIFIED:</b>				
Alcoholic Beverage License Fee	941	976	16,894	16,360
Electrical Energy Tax	-	-	110,329	109,180
Private Rail Car Tax	6,275	6,568	-	-
Penalties on Traffic Violations	-	-	38,759	37,915
Health Care Receipts	2,867	8,346	-	-
Revenues from State Lands	12,218	11,336	52,035	822
Abandoned Property	114,485	224,362	-	-
Trial Court Revenues	453	747	-	-
Miscellaneous	130,840	418,148	2,108,420	1,894,232
<b>Not Otherwise Classified</b>	<b>268,079</b>	<b>670,483</b>	<b>2,326,437</b>	<b>2,058,509</b>
<b>Total Revenues, All Governmental Cost Funds</b>	<b>\$ 32,675,546</b>	<b>\$ 29,824,523</b>	<b>\$ 9,634,242</b>	<b>\$ 8,833,338</b>

See notes on page 1.



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## **APPENDIX B**

### **THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND**

This APPENDIX B includes information about the Department, its Program, the 1943 Fund (including audited financial statements) and the Department's allocation of receipts from Contracts of Purchase, including Excess Revenues.

#### **THE DEPARTMENT**

##### **General**

In 1921, the California Legislature created the Veterans' Welfare Board and the Program. The Department of Veterans Affairs became the successor to the Veterans' Welfare Board under the Farm and Home Purchase Act of 1943. The Department is a subdivision of the State and constitutes a public corporation. One of the Department's basic objectives is to provide eligible veterans the opportunity to acquire homes with long-term low-interest financing provided under the Program.

The California Veterans Board ("Board") determines the policies for all operations of the Department. The Board is composed of seven members appointed by the Governor, subject to Senate confirmation, for respective terms of four years. All of the members of the Board must be veterans, one member must be retired from the active or reserve forces of the United States military service, one member must have substantial training or expertise in mortgage lending and real estate finance, one member must have substantial training or expertise in geriatrics, gerontology, or long-term care, and one member must be a resident of one of the California veterans homes run by the Department established for qualified aged and disabled veterans and their spouses. There now exist three vacancies on the Board.

There are four principal divisions within the Department: the Division of Veterans Services, the Division of Administration, the Veterans' Home Division and the Division of Farm and Home Purchases. The Program is administered by the Division of Farm and Home Purchases with support from the Division of Administration and other Department support units. See "THE PROGRAM."

##### **Administration**

In addition to its headquarters in Sacramento, the Division of Farm and Home Purchases maintains field offices located throughout the State. These local offices, in addition to providing information to all veterans concerning the Program, are responsible for Contract of Purchase originations and the initial collection and evaluation of data regarding applicants for the Program and the properties to be acquired under the Program. This includes examinations as to the qualification of veterans to participate in the Program, a credit analysis for each applicant, appraisals of properties and the initial processing of the veterans' applications for Contracts of Purchase.

Final processing and servicing of the Contracts of Purchase are performed by the Department at its headquarters and entail Contract of Purchase accounting, insurance and property damage claims adjustment and services, Contract of Purchase alterations and contract performance services. The Department allows mortgage brokers to originate Contracts of Purchase. All Contracts of Purchase are serviced by the Department. Effective July 1, 1999 the Department began utilizing its new Integrated Loan Processing and Financial Information System for origination and servicing of all new Contracts of Purchase. General administration of the Program, including fiscal, legal, personnel and other administrative functions, is also

performed at the Department's headquarters. As of January 31, 2001, the Department had a staff of approximately 222 persons in support of the Program.

The Secretary and other staff personnel of the Department principally responsible for the administration of the Program are listed below. The Secretary is appointed by the Governor of the State, serves at the pleasure of the Governor and must be a veteran.

*Bruce Thiesen*  
*Interim Secretary of Veterans Affairs since May 2000*  
*and Deputy Secretary for Operations since January 1999*

Interim Secretary Thiesen is a Vietnam-era Army veteran with a long history as a veterans' activist. Mr. Thiesen has more than 30 years of broad experience as an independent agribusinessman in farm management, farm labor acquisition and benefits administration. Mr. Thiesen served as National Commander of the American Legion in 1993-1994 and from 1995 through 1998 he was appointed by the Secretary of the United States Department of Veterans Affairs as a member of the Veterans Advisory Committee on Rehabilitation. In addition to his work on behalf of veterans, Mr. Thiesen is involved in a number of other community and philanthropic efforts.

*Gerald Rucker*  
*Undersecretary since December 1999*

Mr. Rucker brings a 28-year history of California State management to the Department. Recent experience includes eight years as Chief of Veterans Services Division and State Service Officer for the Department. From May 1999 to December 1999 Mr. Rucker served as Senior Assistant to the Secretary of the Department. Prior to joining the Department management team in 1991, he held a variety of management posts with the departments of Social Services and Rehabilitation. These positions included Personnel Management, Loma Prieta Earthquake Disaster Recovery Team manager as well as assignments with fiscal information technology and systems development responsibility. Mr. Rucker is a service-connected disabled veteran who served with the 1st Cavalry Division in Vietnam, including combat action during the TET Offensive of 1968.

*Sheryl A. Schmidt*  
*Deputy Secretary since November 1996*

After leaving the accounting firm of Touche Ross (now known as Deloitte & Touche LLP) in 1987, Deputy Secretary Schmidt began her state career at the State Controller's Office as a Certified Public Accountant (CPA). In 1995, she accepted the newly created position of Chief of Audits at the Department and developed the Internal Audit Division. In 1996, the Governor of California appointed United States Air Force veteran Sheryl Schmidt as the Deputy Secretary Women Veterans Affairs. Ms. Schmidt also provides administrative oversight over the Information Systems Division and Business Services. Ms. Schmidt holds a Bachelor's degree in management from St. Leo's College in Florida, a Master's of Business Administration (MBA) from California State University, Sacramento, and a CPA license from the California State Board of Accountancy.

*John M. Hanretty*  
*Chief, Financial Services Division since October 1999*

Mr. Hanretty is a United States Air Force, Vietnam-era veteran who graduated from California State University, Sacramento in 1975 with a degree in Government. After graduation, he worked for eight years in the California Department of Health Services regulating Prepaid Health Plans for Medicaid clients. He then spent twelve years in management positions with private health maintenance organizations in Arizona

and California rising to the level of Chief Executive Officer. His responsibilities included sales, medical management, provider staffing, member services, contracting, financial accounting and budgeting. He returned to State government service in 1994 as a Budget Manager. Mr. Hanretty served as the Budget Officer for the Department from August 1998 until December 1999 and was appointed Chief, Financial Services Division in September 1999. He has continuously served on community non-profit boards of directors during his professional career.

*George Flores*  
*Chief, Farm and Home Purchases Division since May 1999*

Mr. Flores has been with the Department for 23 years. He has served as Manager of the Title and Escrow Unit, Headquarters Operation Manager, Southern Regional Manager and the Assistant Division Chief. He is a United States Army veteran who was graduated from California State University, Sacramento, in 1973 with a Bachelors of Science degree in Business Administration, and he attended the McGeorge School of Law, University of the Pacific, Sacramento.

*Kandis L. Mendonsa*  
*Chief, Bond Finance Division since May 1998*

Ms. Mendonsa brings to her current position more than a quarter century of service in California state government. For most of that time, she has worked exclusively in the area of financial management. Prior to joining the Department in 1998, Ms. Mendonsa was employed for 10 years by the Department of Social Services and for 12 years at the State Department of Corrections. While at Corrections, among Ms. Mendonsa's responsibilities was the management of a \$4 billion tax exempt bond program for the construction of youth and adult correction facilities.

*Joseph Maguire*  
*Deputy Secretary/Chief Counsel of Legal Affairs since January 2001*

Mr. Maguire received a bachelor's degree in business administration from American University in Washington, D.C. in 1967. He then served two years in the U.S. Army. After leaving the military he worked in the private sector for several years as a franchise business consultant. He then taught mathematics and science in the Philadelphia Public School System while earning a master's degree in education at Temple University in Philadelphia, Pa. In 1976, Mr. Maguire began attending McGeorge School of Law while teaching science and mathematics at Sacramento Country Day School in Sacramento. After graduating in 1980, Mr. Maguire practiced business law for one year as an associate with a private law firm. Mr. Maguire then became a supervisor and senior trial prosecutor. In January 2001, Governor Davis appointed Mr. Maguire to the position of Deputy Secretary/Chief Counsel for Legal Affairs of the Department.

The Office of Inspector General for Veterans Affairs was created by statute in 1999, and in 2000 the Governor appointed and the Senate confirmed the appointment of an Inspector General for Veterans Affairs. The Inspector General is subject to the direction of the Governor, and is to provide ongoing and independent advice to the Board regarding any issue under Board consideration. The Inspector General is responsible for reviewing and reporting on the operations and financial condition of all veterans programs supported by the State, which include the Program. The Inspector General is required to submit an annual report to the Board and to the State Legislature, which is to include any recommendations for improving the operations of veterans programs, including the Program.

## THE PROGRAM

### General

The Department began making low interest rate farm and home financing available to veterans after World War I, following the enactment by the California Legislature (the "Legislature") of the Veterans Farm and Home Purchase Act of 1921. In 1943, the Legislature enacted the Veterans Farm and Home Purchase Act of 1943 ("1943 Act") which modified the Program to meet new needs of veterans. The 1943 Act was superseded by the Veterans Farm and Home Purchase Act of 1974 ("1974 Act") which again modified the Program. The 1943 Act established the 1943 Fund in the State Treasury, which is the principal fund utilized by the Program.

Since its inception, the Program has assisted over 411,500 veterans to purchase farms and homes throughout the State through long-term housing and farm loans. The sales of revenue bonds (including Revenue Bonds) and Veterans G.O. Bonds, combined with surplus revenues under the Program not needed at any given time to meet the then-current bond retirement schedules and operating costs, have financed the purchase of farms and homes since Program inception. As of April 30, 2001, there were 33,345 Contracts of Purchase outstanding with a remaining principal balance of \$2,678,832,592. As of April 30, 2001, the Department had approximately 235 pending applications for Contracts of Purchase in the approximate total principal amount of \$36,000,000. See EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase" and "– Amounts Expected to be Available to Finance Contracts of Purchase and Related Investments" for information regarding existing Contracts of Purchase and moneys available to finance additional Contracts of Purchase.

The description of the Program under this heading is a description of the Program as it currently exists under the Veterans Code and the Department's implementation thereof. The Veterans Code and the Department's implementation of the Program are subject to change. The Program is also subject to the Federal Tax Code, as noted below.

### Qualifying Veteran Status

*Veterans Code.* A veteran must meet qualifications established under State law in the Veterans Code in order to participate in the Program. The qualifications specified in the Veterans Code are subject to change by the Legislature. The Veterans Code currently requires, generally, that a veteran must have served at least ninety days on active duty in the Armed Forces of the United States, unless sooner discharged because of a service-connected disability, or as a member of the National Guard or reserves called to active duty by Presidential order, and must have received an honorable discharge or been released from active duty under honorable conditions. The Veterans Code allows the Department to finance Contracts of Purchase for:

- (a) veterans who have served during one of the following periods:
    - (i) April 6, 1917 through November 11, 1918; December 7, 1941 through December 31, 1946; or June 27, 1950 through January 31, 1955 (such veterans are referred to as "Earlier War Veterans");
    - (ii) February 28, 1961 through August 4, 1964 if the veteran served in the Republic of Vietnam during that period ("Early Vietnam Veterans"); or August 5, 1964 through May 7, 1975 (all veterans referred to in this clause (ii) are "Vietnam Era Veterans");
- or

(iii) on or after August 2, 1990, through a date as yet to be determined by the President of the United States; at any time in Somalia, or in direct support of the troops in Somalia, during Operation Restore Hope; or at any time in an expedition or campaign for which a medal was authorized by the United States Government such as the Armed Forces Expeditionary and Vietnam Service Medals (such veterans are referred to as "Recent War Veterans"); and

(b) any person who qualifies under the Federal Tax Code for financing from Revenue Bonds or unrestricted funds of the Department and who served in the active military, naval, or air service for a period of not less than 90 consecutive days and who received an honorable discharge or was released from active duty under honorable conditions (such veterans are referred to as "Peacetime Veterans").

Amendments to the Veterans Code effective January 1, 1998 added Early Vietnam Veterans and Peacetime Veterans as veterans eligible to receive Contracts of Purchase. These amendments, together with various financial and programmatic changes implemented by the Department, have significantly increased the universe of potential eligible veterans and increased demand for Contracts of Purchase. See EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA."

*Federal Tax Code.* In order to determine which Department moneys can be used to finance Contracts of Purchase, the Department must also take into account the requirements of Federal law set forth in the Federal Tax Code, which limits the universe of veterans eligible to receive Contracts of Purchase financed from certain sources. See APPENDIX E – "CERTAIN FEDERAL TAX CODE REQUIREMENTS." Applying the current Federal Tax Code separates the Department's lendable moneys into three classes:

(a) "Unrestricted Moneys" (derived from certain moneys in the 1943 Fund, certain proceeds of pre-Ullman (as defined below) Revenue Bonds and Veterans G.O. Bonds, and certain future issues of taxable bonds, if any), which can finance Contracts of Purchase for those veterans who qualify under the applicable provisions of the Veterans Code (there are no loan eligibility requirements imposed by the Federal Tax Code with respect to Contracts of Purchase financed by Unrestricted Moneys; these are requirements principally limiting the family income of applicants and the property purchase price, and, subject to certain exceptions, requiring that the veteran not have had a present ownership interest in his principal residence in the three years prior to obtaining such financing ("QMB Loan Eligibility Requirements")). The Department has implemented a policy (which is subject to change) to make such moneys available for Earlier War Veterans, Vietnam Era Veterans, and Recent War Veterans. ("Pre-Ullman" refers to the period prior to enactment of Federal Tax Code programmatic restrictions on the use of proceeds of tax-exempt bonds to finance mortgage loans.);

(b) "Qualified Veterans Mortgage Bond Proceeds" (derived exclusively from proceeds of Veterans G.O. Bonds) which can finance Contracts of Purchase for any veteran who (i) qualifies under the Veterans Code, (ii) served on active duty prior to January 1, 1977, and (iii) was released from active duty fewer than 30 years before receiving such financing. The last date of veteran eligibility under clause (iii) is December 31, 2036 for a veteran with 30 years of continuous service after December 31, 1976. (The QMB Loan Eligibility Requirements do not apply to Contracts of Purchase financed by moneys derived exclusively from proceeds of Veterans G.O. Bonds.) These proceeds can finance Contracts of Purchase for Earlier War Veterans and Vietnam Era Veterans; and

(c) "Qualified Mortgage Bond Proceeds" (which are principally derived from Revenue Bond proceeds), can finance Contracts of Purchase for any veteran who (i) qualifies under the Veterans Code, and

(ii) satisfies the QMB Loan Eligibility Requirements. These proceeds can finance Contracts of Purchase for Earlier War Veterans, Vietnam Era Veterans, Recent War Veterans, and Peacetime Veterans.

### **Allocation of Lendable Moneys**

For those veterans seeking financing who would qualify for Contracts of Purchase from two or more of the above-described financing sources, the Department will select the source of funds to use in its sole discretion. The Department's goal is to maximize the availability of Program benefits. The Board has approved a policy (which is subject to change) to make Qualified Mortgage Bond Proceeds derived from Revenue Bonds the only financing source for Contracts of Purchase for veterans who did not serve during "wartime" (as defined in the Veterans Code).

### **Administration of the Farm and Home Purchase Program**

The Department finances new and existing single-family homes, farms and mobile homes located in the State by acquiring the property selected by a veteran under a Contract of Purchase. The Department also finances home improvements with respect to properties covered by existing Contracts of Purchase, subject to applicable restrictions of the Federal Tax Code. A Contract of Purchase creates an installment land contract between the Department and the veteran which is somewhat analogous to a loan from the Department to the veteran. The amount which the Department finances is reflected in the Contract of Purchase as the "purchase price." See "THE PROGRAM – CONTRACTS OF PURCHASE" in this APPENDIX B.

At present under the Veterans Code, the maximum purchase price to the Department of an existing home or the sum to be expended by the Department pursuant to a Contract of Purchase for a home to be constructed is \$250,000 and for farms is \$300,000 (*except* that the limitation with respect to certain mobile homes in mobile home parks is \$70,000 and *except* that the maximum purchase price for any home may be increased by an additional \$5,000 for certain purposes). The Legislature has periodically made changes in the maximum amount that may be financed under a Contract of Purchase. The Federal Tax Code imposes maximum purchase prices on properties which are the subject of Contracts of Purchase financed by Qualified Mortgage Bond Proceeds. The Federal Tax Code permits such maximums to be adjusted periodically. (No Federal Tax Code purchase price limits apply to Contracts of Purchase financed from Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds.) These Federal Tax Code requirements vary depending upon where the property is located, if it is in a targeted or non-targeted area, and whether it is a new or existing home. The maximum purchase price under the Program is, therefore, the Veterans Code maximum amount or, if the Contract of Purchase is being financed by Qualified Mortgage Bond Proceeds, the lesser of the Veterans Code maximum amount or the maximum amount under applicable provisions of the Federal Tax Code.

Although the Veterans Code does not impose maximum income limits, the Federal Tax Code imposes maximum income limits applicable only to veterans obtaining Contracts of Purchase financed by Qualified Mortgage Bond Proceeds. The income limits vary by statistical area and family size. No maximum income limits apply to veterans obtaining Contracts of Purchase financed by Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds.

Any veteran who qualifies under the Veterans Code and the Federal Tax Code may be granted a subsequent Contract of Purchase so long as any previous Contract of Purchase has been paid in full or the veteran lost his interest in the previous Contract of Purchase through divorce or dissolution of marriage.

## **Contracts of Purchase**

*General.* Pursuant to the Program, the Department and the veteran enter into a Contract of Purchase for a farm, home or mobile home. Under a Contract of Purchase, the veteran has the benefits of ownership as the equitable owner, but title to the property and improvements is held by the Department as the legal owner until the final principal payment is made. Property sold under a Contract of Purchase may not be transferred, assigned, encumbered, leased, let or sublet without the written consent of the Department. Any permitted encumbrance must be junior or secondary to the Department's interest in the property.

Before 1998, Contracts of Purchase were not insured or guaranteed by the Federal Housing Administration, the United States Department of Veterans Affairs (the "USDVA"), Rural Development (formerly Farmers' Home Administration), or any private primary mortgage insurer. In 1998, the Department was approved by the USDVA as an originator of loans eligible to receive a guaranty from the USDVA. In addition to the USDVA guaranty, the Department has secured primary mortgage insurance for certain prior and all future Contracts of Purchase with loan-to-value ratios ("LTV") above 80% from Radian Guaranty Inc. ("Radian"). See "THE PROGRAM - Loan Insurance - Primary Mortgage Insurance." Certain Contracts of Purchase are not the subject of loan insurance or guarantees. See EXHIBIT 2 to this APPENDIX B - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Contracts of Purchase - Existing Contracts of Purchase."

The terms of the Contracts of Purchase are substantially identical, except for interest rates on Contracts of Purchase originated after January 1, 1999, regardless of whether they are funded by Unrestricted Moneys, Qualified Veterans Mortgage Bond Proceeds or Qualified Mortgage Bond Proceeds, except for Federal Tax Code-mandated differences in Contracts of Purchase financed with Qualified Mortgage Bond Proceeds. Two ways in which such Contracts of Purchase are different are: (a) Contracts of Purchase financed by Qualified Mortgage Bond Proceeds have more restrictions on the right of a purchaser to assume the obligations under the Contract of Purchase than do Contracts of Purchase financed by Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds; and (b) certain Contracts of Purchase financed by Qualified Mortgage Bond Proceeds are subject to Federal Tax Code-mandated recapture provisions. In addition, the Federal Tax Code contains numerous loan eligibility restrictions on borrowers receiving financing from proceeds such as Qualified Mortgage Bond Proceeds. These restrictions require, among other things, and subject to certain exceptions contained in the Federal Tax Code, that borrowers (i) not have had a present ownership interest in their principal residence during the three-year period preceding the extension of financing, (ii) are eligible to finance the purchase of residences with purchase prices not in excess of limits stated in the Federal Tax Code, (iii) must not have family incomes in excess of limits stated in the Federal Tax Code, (iv) may not use the proceeds of the financing to refinance an existing mortgage loan, and (v) may use the proceeds of the financing only to finance one-family or one-to-four family dwelling units meeting certain criteria. The Federal Tax Code includes certain procedures that an issuer of Qualified Mortgage Bonds may undertake to satisfy these requirements but requires that 95% or more of the proceeds of the issue be used in full compliance with the loan eligibility restrictions.

Since the number and aggregate principal balance of Contracts of Purchase relating to farms and mobile homes and Contracts of Purchase financed pursuant to the 1943 Act are statistically insignificant, the discussion below is limited to Contracts of Purchase financed under the 1974 Act for homes, excluding farms and mobile homes in rental parks, unless otherwise indicated. See EXHIBIT 2 to this APPENDIX B - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Contracts of Purchase - Existing Contracts of Purchase."



Many factors affect the ability or willingness of homebuyers to make mortgage loan payments and of potential homebuyers to borrow money to purchase homes. These factors include, among others, general economic conditions and costs of living.

*Origination.* The Veterans Code, in most cases, requires the veteran to make an initial payment of 2% of either the purchase price or the market value of the property, whichever is less. In the case of veterans who are ineligible for a full USDVA guaranty, Department policy requires the veteran to make an initial payment of 3% of either the purchase price or the market value of the property, whichever is less. The balance of the purchase price, including USDVA guaranty fees, may be amortized over a period fixed by the Department, not exceeding 30 years and 32 days for all Contracts of Purchase guaranteed by USDVA, and 40 years for any other Contracts of Purchase. Pursuant to its policy, the Department issues all new Contracts of Purchase for terms of 30 years unless a shorter term is requested. Existing contracts are occasionally extended beyond 30 years in cases of extreme financial hardship.

In addition to the initial payment referred to in the prior paragraph, a Loan Origination Fee ("LOF") of 1% of the loan amount is collected at close of escrow on all contracts issued after January 1, 1999. This fee must be paid in escrow by the buyer or seller. If the loan application is submitted through an approved mortgage broker, the 1% fee is paid directly to the mortgage broker through the escrow. Otherwise, the fee is retained by the Department. While the Department's field offices will continue to originate Contracts of Purchase, the Department expects the bulk of the Contracts of Purchase to be originated by mortgage brokers. After a preliminary screening in the field offices, applications will be forwarded to a centralized underwriting unit in Sacramento for processing. The mortgage brokers deal directly with the central underwriting, escrow and administrative staff in Sacramento. An appraisal fee of \$300 to \$425 is collected from the applicant and is paid directly to the appraiser upon completion of the assignment. In rare cases, where the appraisal is performed by a Department employee, the fee is retained by the Department.

The Veterans Code permits the Department to finance permanent home and property improvements for veterans with existing Contracts of Purchase. When a home improvement loan is approved, total financing, including the balance of the original loan, the amount of the improvement loan, and any other encumbrances, cannot exceed 90% of the improved market value of the property. Typically this total LTV ratio is much lower than 90%. Improvement loans are not approved for veterans who have had significant delinquencies in the 12 months immediately preceding the application. Funds are disbursed by the Department directly to the contractors (or vendors) as the improvements are completed. A separate Contract of Purchase covering only the improvements is executed, bearing interest at the same rate as the veteran's existing Contract of Purchase. The new Contract of Purchase is payable over a term up to 15 years based on the amount of the Contract of Purchase. In no event can the term, from the inception of the original Contract of Purchase through the pay-off of the improvement Contract of Purchase, exceed 40 years. A LOF of 1.5% of the improvement Contract of Purchase amount is charged. The maximum home improvement loan for veterans funded with Qualified Mortgage Bond Proceeds is \$15,000 over the term of the original Contract of Purchase. Home improvement loans funded with Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds are available up to a maximum of \$50,000. Subsequent home improvement Contracts of Purchase may be granted, if funds are available, so long as there is only one home improvement Contract of Purchase to any veteran outstanding at any time. Currently, less than one percent of the total principal balance of all Contracts of Purchase is derived from home improvement loans.

Contracts of Purchase for the purchase of a building site and construction of a home are available. Qualifying sites include undeveloped sites/acreage, lots in subdivision developments, and sites in non-profit self help developments. Mobile homes in parks do not qualify. Construction of the improvements must be

performed by a licensed California contractor. The Department does not submit Contracts of Purchase which finance home construction for USDVA guaranty.

The Department also limits availability of financing to veterans on the basis of their personal credit status. The Department's current lending criteria conform to those of the USDVA for participation in the USDVA guaranty program for all Contracts of Purchase, including those not eligible for USDVA guarantees. Department procedures are consistent with those established by USDVA for its loan guaranty program.

The history of the Department's originations of Contracts of Purchase is set forth in EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Contracts of Purchase Origination and Principal Repayment Experience."

*Servicing.* All Contracts of Purchase are serviced by the Department. Late penalty charges are applied to Contracts of Purchase that have a remaining amount due of \$25 or more at the close of any account month. A \$10 late penalty charge is imposed on Contracts of Purchase originated before October 1984. Contracts of Purchase originated during and after October 1984 are subject to a late penalty charge of 4% of the principal and interest portion of the installment, consistent with penalties authorized by USDVA.

The Department may, in any individual case and for good cause, permit the postponement from time to time, and upon such terms as it deems proper, of the payment of the whole or any part of any installment. Contracts of Purchase may also have terms in excess of 30 years if home improvement loans have been obtained, as discussed above. The terms of Contracts of Purchase guaranteed by USDVA, however, cannot exceed 30 years and 32 days.

*Prepayment Penalties.* There are no prepayment penalties on any Contracts of Purchase.

*Cancellations and Delinquencies.* The Department's policies regarding delinquencies and cancellations conform to USDVA loan guaranty program requirements. In the event of a failure to comply with any of the terms of a Contract of Purchase, the Department may cancel the Contract of Purchase and be released from all obligations, at law or in equity, to convey the property. In such event, the veteran's rights under the Contract of Purchase may be forfeited and all payments made by the veteran prior to termination of the Contract of Purchase deemed to be rental paid for occupancy. Upon such forfeiture, the Department takes possession of the property covered by the Contract of Purchase and resells it.

If a veteran does not make a payment by the close of the account month in which the payment is due (usually the 18th day of the month), the payment is considered "delinquent." A warning letter is issued on the 20th day of the same account month which advises the veteran that the account is delinquent. Department personnel initiate telephone contact with veterans with delinquent accounts. If the account remains delinquent through the second account month, a Notice of Intent to Cancel Contract is issued at the beginning of the third account month giving notice that the Contract of Purchase may be canceled at the end of the 30-day notice period unless the account is brought current. A schedule for liquidation of delinquent payments satisfactory to the Department is arranged during this period; *however*, if the account remains delinquent after such 30-day period and no schedule for liquidation of delinquent payments has been agreed upon, the Department may begin cancellation of the Contract of Purchase. The Department's headquarters Central Collections Unit monitors the delinquency throughout this process, orders a title search to identify any junior lienholders and forwards the pertinent information to the Department's Foreclosure Unit for further precancellation processing in accordance with the California Code of Regulations, Title 12, Section 344, Military and Veterans Affairs. Junior lienholders are identified and sent notices giving them 30 days (40 days in the case of Federal tax liens) to protect their interest by beginning foreclosure proceedings. If the account is not brought current during such notice period to junior lienholders and no junior lienholder proceeds with a

foreclosure action to protect its interest, the Department's Foreclosure Unit cancels the contract, and a Notice of Cancellation is mailed to the veteran and recorded. The Department's Foreclosure Unit then takes steps to evict occupants and clear any remaining liens. If judicial action is required, the case is referred to the Department's Law Division for additional processing.

After all remaining liens are removed and the property is vacant, the repossessed property is repaired and improved, if necessary, and is marketed through the Department's centralized repossession sales unit. The Department is required to advertise and accept sealed offers after a 2-week period, and the property is sold to the highest acceptable bidder. If no acceptable bids are received, the property is sold through a real estate broker and a commission of between 3% to 6% of the selling price is paid.

Federal law provides certain protections to military personnel on active duty or reservists ordered to report for military service under The Soldiers' and Sailors' Civil Relief Act of 1940, as amended. If a veteran obtained a Contract of Purchase prior to the relevant period of military service, then during the period of military service the interest rate on the Contract of Purchase cannot exceed 6% (unless the ability of the veteran to pay interest in excess of 6% is not materially impaired by such military service). Also, the veteran may seek a stay (or a court may on its own motion grant a stay) of any court action or proceeding.

See EXHIBIT 2 to this APPENDIX B - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - CONTRACTS OF PURCHASE - Cancellations and Delinquencies" for additional information regarding the status of Contracts of Purchase.

*Interest Rates.* Contracts of Purchase originated prior to January 1, 1999 bear interest at a rate which is set by the Department and may be changed with the approval of the Board and the Veterans' Finance Committee of 1943 (the "Finance Committee"). Most of such Contracts of Purchase currently bear interest at a rate of 6.95%. The Veterans Code currently requires that, generally, all Contracts of Purchase originated prior to January 1, 1999 (the "pre-1999 Contracts of Purchase") bear the same interest rate. In accordance with the current provisions of the Veterans Code, the interest rate for pre-1999 Contracts of Purchase can be changed annually as deemed necessary. The effective date of a higher rate of interest on pre-1999 Contracts of Purchase may occur only once in any calendar year unless a finding is made by the Board and the Finance Committee that such additional action is necessary to protect the solvency of the 1943 Fund.

Legislation passed in 1998 (i) eliminated the uniform interest rates requirement for Contracts of Purchase originated on or after January 1, 1999; (ii) allows the Department to establish non-uniform fixed or variable interest rates for such Contracts of Purchase; and (iii) allows the Department to modify such interest rates, or the methodology and timing for determining or modifying interest rates, from time to time, subject to the approval of the Board and the Finance Committee. The Department received approval to implement a flexible mechanism to provide for periodic adjustments of the interest rate on new Contracts of Purchase funded from Qualified Mortgage Bond Proceeds, Qualified Veterans Mortgage Bond Proceeds, and Unrestricted Moneys. As a result of such mechanism, interest rates for new Contracts of Purchase funded on and after March 1, 2001 are 6.40% for Contracts of Purchase financed using Qualified Mortgage Bond Proceeds, 6.50% for Contracts of Purchase financed using Qualified Veterans Mortgage Bond Proceeds, and 7.95% for Contracts of Purchase using Unrestricted Moneys, although the interest rate may soon change for new Contracts of Purchase using Unrestricted Moneys. Interest rates on Contracts of Purchase are expected to be established in the future based on various factors deemed appropriate by the Department, subject in all cases to the requirements of the resolution authorizing the issuance of Revenue Bonds (the "Revenue Bond Resolution") for the filing of Cash Flow Statements and conformance with Program Operating Procedures. As noted herein, the Program Operating Procedures are operating policies of the Department governing the discretionary activities of the Department under the Revenue Bond Resolution. The Cash Flow Statement consists of the conclusion by an authorized representative of the Department that projected revenues will be

sufficient to provide for timely payment of principal of and interest on the Revenue Bonds and expenses, under each scenario included in the quantitative analysis which accompanies the Cash Flow Statement.

### **Loan Insurance**

Since 1997, the Department has completed several programmatic changes, including obtaining loan insurance from a private primary mortgage insurer for certain existing Contracts of Purchase with high LTVs, and USDVA guarantees or private primary mortgage insurance for all new Contracts of Purchase (except mobile homes in parks and home improvement loans) with LTVs above 80% up to 100%. In addition to the LOF and initial payment, the Department collects a funding fee of from 1.25% up to 3% of the Contract of Purchase amount, based on the LTV for each Contract of Purchase which exceeds an LTV of 80%. The fee may be paid in escrow by the buyer or seller, or it may be added to the base loan amount. Veterans described above who are ineligible for a full USDVA guaranty and therefore are obligated to make an initial 3% payment must advance a funding fee of up to 2% of the base loan amount to the Department at close of escrow, and the funding fee may not be added to the base loan amount. With respect to eligible Contracts of Purchase, this fee is paid to the USDVA for the cost of the loan guaranty. If the veteran or the property is not eligible for a USDVA loan guaranty, the funding fee is retained by the Department, and a portion of such funding fees is used by the Department to pay costs related to the Radian primary mortgage insurance. Although the Department has no current expectation that it will change its current policies regarding insurance and guarantees, it may change such expectations. Any change to the foregoing insurance and guaranty expectations could require an amendment to the Department's Program Operating Procedures and delivery of a new Cash Flow Statement. A significant principal amount of Contracts of Purchase, including Contracts of Purchase with LTVs above 80%, are not covered by loan insurance. See EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase."

*Primary Mortgage Insurance.* The Department purchased from Radian a policy of primary mortgage insurance for a pool of certain prior Contracts of Purchase with LTVs above 80%. This Radian policy provides coverage on such pool back to February 1, 1998. The Department has purchased an additional policy of primary mortgage insurance from Radian which provides the same coverage as provided in the original policy, except that the Department now includes certain existing and all new Contracts of Purchase with 97% to 100% LTV ratios that are not qualified for USDVA guarantees (except mobile homes in parks, construction loans and home improvement loans, all of which continue to be covered by the Department). Under this second policy, Radian has committed to insure Contracts of Purchase until the earlier of December 31, 2004 or when the aggregate principal amount of Contracts of Purchase insured under the second policy reaches \$1.6 billion. Each of the Radian policies provides for coverage for aggregate losses incurred on Contracts of Purchase following property disposition, above an aggregate 2% deductible based upon a percentage of the originally insured balances of the Contracts of Purchase of the applicable pool. Under both Radian policies, once the applicable aggregate deductible has been reached, insurance claims may be made based upon the individual LTV of the particular defaulted Contract of Purchase, as set forth below. For these purposes, LTV is calculated using the original appraised value of the property.

**Radian Mortgage Insurance Coverage Rates Subject to a  
Deductible of 2% of the Originally Insured Balances of the  
Contracts of Purchase in the Applicable Insured Pool**

<u>LTV Category</u>	<u>% of Coverage</u>
97.01% to 100.00%	35%
95.01% to 97.00%	35%
90.01% to 95.00%	30%
85.01% to 90.00%	25%
80.01% to 85.00%	17%

See EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase."

*USDVA Guaranty Program.* The Department was approved by the USDVA as a "supervised lender with automatic processing authority" as of March 10, 1998. On July 27, 1998, the Department received USDVA approval under the Lender Appraisal Processing Program ("LAPP") to process appraisals and determine reasonable value without prior USDVA review. The Department seeks USDVA loan guarantees for all Contracts of Purchase with an LTV of 80% or higher, unless the Contract of Purchase is not eligible for USDVA guaranty. Contracts of Purchase not eligible for guaranty are primarily contracts with veterans who have previously used their USDVA guaranty eligibility and do not qualify for reinstatement, and contracts for the purchase of new homes not inspected by USDVA during construction. Also, a very small number of veterans have service that meets Veterans Code eligibility requirements but does not meet USDVA eligibility requirements.

The Servicemen's Readjustment Act of 1944, as amended, permits a veteran (or in certain instances the veteran's spouse) to obtain a mortgage loan guaranty from USDVA covering mortgage financing of the purchase or construction of a one-to-four family dwelling unit at interest rates permitted by USDVA. The USDVA program has no preset mortgage loan limits and permits the guaranty of mortgage loans of up to 30 years and 32 days' duration. Under the USDVA program, the maximum USDVA guaranty on a loan is the lesser of (a) the veteran's available entitlement (a maximum of \$36,000, or if the original loan amount exceeds \$144,000, a maximum of \$50,750), or (b) (1) 50% of the original loan amount if such amount does not exceed \$45,000, (2) \$22,500 if the original loan amount is between \$45,000 and \$56,250, (3) the lesser of \$36,000 or 40% of the original loan amount, if such amount is between \$56,250 and \$144,000, or (4) the lesser of \$50,750 or 25% of the original loan amount, if such amount is in excess of \$144,000. The liability on the guaranty is reduced or increased pro rata with any reduction or increase in the amount of indebtedness, but in no event will the amount payable on the guaranty exceed the amount of the original guaranty. Notwithstanding the dollar and per centum limitations of the guaranty, a mortgage holder will ordinarily suffer a monetary loss only where the difference between the unsatisfied indebtedness and the proceeds of a foreclosure sale of a mortgaged property is greater than the original guaranty as adjusted. Periods without interest payments prior to foreclosure will also increase the potential for losses. In the event of a default in the payment of a USDVA loan, but prior to a suit or foreclosure, USDVA may, at its option, pay to a mortgage holder the unpaid balance of the obligation plus accrued interest and receive an assignment of the loan and security.

### **Property and Life and Disability Insurance**

The Veterans Code and/or long-standing Department policy have called for a veteran to maintain certain insurance with respect to the property covered by a Contract of Purchase. Insurance must be in the amount and under the conditions specified by the Department, and is either provided by the Department or

by insurance companies selected by the Department. Any change to the insurance requirements could require amending the Department's Program Operating Procedures.

*Fire and Hazard Coverage.* The Department self-insures for fire and hazard losses, using the 1943 Fund to make payments to veterans, up to a Department deductible. The Master Policy described below (the "Master Policy") provides coverage in excess of the Department deductible, except that the Master Policy does not cover mobile homes, condominiums or planned unit development properties covered by blanket insurance policies provided by homeowners' associations. The Master Policy is provided by commercial insurers (the "provider"). The lead insurance company for the provider is Affiliated F.M. Insurance Company.

Under each Contract of Purchase, the veteran is required to pay the sum charged to his or her account to cover costs of providing the insurance coverage including the insurance premium due under the Master Policy with respect to his or her property. From the amount charged to each veteran, the Department retains a portion to provide the sums necessary to pay all losses up to the Department deductible, which is \$1,250,000 per occurrence or \$10,000,000 per policy year. If the total losses from a single occurrence exceed \$1,250,000 or if the aggregate of all fire and hazard insurance losses for a policy year exceed \$10,000,000, liability for the excess will be covered under the Master Policy. The coverage under the Master Policy extends to October 31, 2001. The Master Policy is an all-physical loss form.

Fire and hazard insurance coverage for participants in the Program is adjusted annually to reflect increasing building costs and is maintained on a guaranteed replacement cost basis for homes and on an actual cash value basis for outbuildings. A \$250 deductible payable by the veteran applies to each loss. Claims must be submitted within 12 months of loss. Each veteran with a Contract of Purchase pays an annual insurance premium equal to \$0.22 per \$100 of insured value which is prorated and included in the veteran's monthly installment. Claims adjustments and payments are made on behalf of the Department and the provider of the Master Policy by an affiliate of such provider.

*Disaster Indemnity Plan.* The Department provides certain disaster indemnity and catastrophe real property insurance ("Disaster Indemnity Plan"). Neither such insurance nor the indemnity fund described below are payable from or a part of the 1943 Fund. The Disaster Indemnity Plan indemnifies participants against the cost of repairing damage in excess of a deductible caused by flood, earthquake or other perils not covered by the fire and hazard insurance policy (not otherwise excluded). The deductible for flood losses is \$500 and the deductible for earthquake losses is \$500 or 5% of the amount of loss, whichever is higher. The catastrophe insurance has been obtained from a consortium of twelve insurance companies for a total of \$50,000,000 of coverage with a \$4,000,000 deductible per occurrence and in the aggregate annually; \$100,000 per occurrence maintenance deductible thereafter. The 2000-2001 one-year premium for this coverage is \$3,385,000.

Each veteran in the Program participates in the Disaster Indemnity Plan and pays his or her pro rata share of the annual premium. Such payments are deposited in an indemnity fund created in the Treasury of the State to be utilized to pay the deductible discussed above. Each veteran pays an initial assessment of \$.95 per \$1,000 of insured value, and any assessments as may be required to sustain the indemnity fund. The value of the indemnity fund as of June 30, 2000 was \$17,309,407.

Effective December 1, 1997, the Department has purchased individual flood policies through the Federal Emergency Management Agency ("FEMA") covering all properties financed by Contracts of Purchase that are located in designated flood zones. Coverage under this policy extends to December 1, 2001.

*Life and Disability Insurance* age. In the past, the Department self-insured from the 1943 Fund life and disability coverage for veterans with Contracts of Purchase. Following a period of significant and recurring losses incurred by the 1943 Fund, the Department, effective June 1, 1996, replaced most of the Department's self-insured life and disability insurance program with an interim life and disability insurance plan (the "Life and Disability Plan") provided by Pacific Life and Annuity Company ("Pacific Life") (previously PM Group Life Insurance Company). Effective February 1, 1998, after a competitive bidding process, the interim plan was replaced with a long-term life insurance and disability plan, also provided by Pacific Life. The Department continues to self-insure those veterans who were already receiving disability benefits at the time the Life and Disability Plan was implemented, with benefits equal to the amount of the monthly Contract of Purchase payment at the time of their disability. Those benefits will continue under the provisions of the self-insured plan until the beneficiary returns to active employment or dies, or his or her contract is paid off. Loss reserves for these obligations are actuarially based. A portion of the required loss reserves is maintained under a third-party administrator agreement and is shown in the financial statements for the 1943 Fund as deposits with insurance administrators. The remaining amount is unfunded, but reserved in the form of a loss against retained earnings. See "THE 1943 FUND - Selected Financial Data of the 1943 Fund and Department's Discussion" in this APPENDIX B.

As noted above, effective February 1, 1998, the Department implemented a new life and disability protection plan which is provided by Pacific Life. All holders of Contracts of Purchase who had life and disability coverage (exclusive of those receiving self-insured benefits as described in the preceding paragraph) under the prior plan were transferred automatically to the new plan. Major elements of the life and disability coverage will continue unchanged for all currently insured Contract of Purchase holders up to age 60. For formerly insured holders of Contracts of Purchase under age 60, 100% of the loan balance is covered. Life insurance coverages at subsidized rates for those currently insured Contract of Purchase holders in the program over age 60 are limited to a maximum of the loan amount or \$75,000, if less, reducing in increments every 5 years to a maximum of \$5,000 after age 80. If they so desire, such Contract of Purchase holders can obtain, at commercial insurers' rates, coverage for loan balances in excess of such amounts. Holders of new Contracts of Purchase after February 1, 1998 are covered under a revised insurance plan. The Department continues to require life insurance coverage but in an amount sufficient to cover home payments for five, three or one year(s) depending on the health of the individual loan applicant. All new Contract of Purchase applicants must apply for and must be provided the minimum life insurance coverage. Disability coverage for a period up to two years is optional for new Contract of Purchase holders after February 1, 1998, but is a mandatory requirement for Contract of Purchase holders with Contracts of Purchase in existence prior to February 1, 1998. The disability insurance benefit provides home loan protection by paying the participant's monthly loan installment (including insurance premiums) for a maximum benefit period of two years per disability, unless due to a psychiatric condition which would then limit the maximum benefit period to 12 months. Additional, full coverage, life insurance may also be purchased as an option by new Contract of Purchase holders. Spouse life insurance coverage is available as an option. The new plan is an experience rate plan subject to annual rating reviews of insurance claims, expenses, risk charges, profits and premiums. In addition to the new insurance coverages, the Department has established a one-time \$5 million rate stabilization reserve intended to minimize the impact of premium increases for Contract of Purchase holders. The Department will retain the principal amount of such \$5 million and any interest earnings on such amount as part of the 1943 Fund.

The Department's life and disability insurance program is the subject of a state audit report released in March 2001. See "External Reviews of the Program" in this APPENDIX B. The Department is in the process of going out to bid to determine the premium cost of increasing the disability benefits for Contract of Purchase holders.

## THE 1943 FUND

### General

The components of the 1943 Fund are (i) proceeds derived from the sale of Revenue Bonds, (ii) proceeds from the sale of Veterans G.O. Bonds, (iii) amounts receivable under all Contracts of Purchase and from sales of properties subject to cancelled Contracts of Purchase, (iv) temporary investments, cash and funds, and (v) certain other miscellaneous assets. Proceeds of Veterans G.O. Bonds may not be applied to payment of principal of, and interest or any redemption premium on, the Revenue Bonds. The holders of Revenue Bonds are not entitled to compel the sale of Contracts of Purchase and the properties to which they relate, but are entitled to receive payment out of the Revenues derived from those Contracts of Purchase and properties, subject to the prior claims, if any, of the Veterans G.O. Bonds.

In addition to financing Contracts of Purchase and paying or reimbursing of debt service on the Veterans G.O. Bonds and Revenue Bonds, as described below, moneys in the 1943 Fund are used to pay administrative costs of the Department, and to fund certain losses from and reserves for property insurance and life and disability insurance described above in this APPENDIX B under "THE PROGRAM – Property and Life and Disability Insurance."

For financial information concerning the 1943 Fund, see "Selected Financial Data of the 1943 Fund and Department's Discussion" and also see EXHIBIT 1 to this APPENDIX B – "FINANCIAL STATEMENTS OF THE 1943 FUND FOR FISCAL YEARS 2000 AND 1999 AND INDEPENDENT AUDITOR'S REPORT."

The Act and the Veterans Code provide that the undivided interest created by Resolution RB-1 in favor of the holders of Revenue Bonds in the assets of the 1943 Fund is secondary and subordinate to the interest of the people of the State and the holders of Veterans G.O. Bonds. Moneys in the 1943 Fund must be paid, on the debt service payment dates of Veterans G.O. Bonds, to the General Fund in the amount of the principal of (whether at maturity or upon redemption or acceleration), and premium and interest on Veterans G.O. Bonds then due and payable (other than debt service payable from the proceeds of refunding bonds). Debt service on Veterans G.O. Bonds is payable from the General Fund, even if the amount transferred from the 1943 Fund to the General Fund is less than such debt service amount. The balance remaining unpaid to the General Fund from the 1943 Fund must be transferred to the General Fund out of the 1943 Fund as soon thereafter as it becomes available, together with interest thereon at the rate borne by the applicable Veterans G.O. Bonds, compounded semiannually. Until such amounts are repaid to the General Fund, no payments may be made on the Revenue Bonds other than from amounts then in the Bond Reserve Account and the Loan Loss Account. These rights with respect to the 1943 Fund do not grant any lien on the 1943 Fund or the moneys therein to the holders of any Veterans G.O. Bonds.

As of April 1, 2001, there were outstanding \$2,419,070,000 aggregate principal amount of Veterans G.O. Bonds, not including the Offered Veterans G.O. Bonds, and \$538,435,000 aggregate principal amount of Revenue Bonds. \$647,585,000 of new issue Veterans G.O. Bonds are authorized but not issued. The Offered Veterans G.O. Bonds will use \$42,000,000\* of such \$647,585,000 authorization. Under the Act, Revenue Bonds in an aggregate principal amount not to exceed \$1,500,000,000, at any given time, may be outstanding. The Legislature may increase the amount of Revenue Bonds issuable under the Act or may decrease such amount to an amount not less than the amount of Revenue Bonds then outstanding. See "THE OFFERED VETERANS G.O. BONDS – Purpose" for information about the issuance of Revenue Bonds and Veterans G.O. Bonds during 2001. Additional information about outstanding Veterans G.O. Bonds and

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\*Preliminary, subject to change



Revenue Bonds is in EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Veterans G.O. Bonds and Revenue Bonds."

For additional information regarding the existing interest rates of, and setting interest rates on, Contracts of Purchase, see "THE PROGRAM – Contracts of Purchase" in this APPENDIX B and EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase."

### **Selected Financial Data of the 1943 Fund and Department's Discussion**

#### *Selected Financial Data of the 1943 Fund*

The following selected financial data of the 1943 Fund for fiscal years ended June 30, 2000 and 1999 have been derived from the financial statements of the 1943 Fund audited by Deloitte & Touche LLP, independent auditors, whose report thereon appears in EXHIBIT 1 to APPENDIX B in this Official Statement. The following selected financial data of the 1943 Fund for fiscal years ended June 30, 1998, 1997 and 1996 have also been derived from the audited financial statements of the 1943 Fund which are not included herein. **This selected financial data should be read in conjunction with the financial statements and notes thereto of the 1943 Fund contained in said EXHIBIT 1 and the Department's Discussion of Financial Data contained herein.**

Beginning with the fiscal year ended June 30, 1998, the financial statements of the 1943 Fund are required to reflect accounting changes required by promulgation of Statement No. 31 by the Governmental Accounting Standards Board ("GASB 31"). GASB 31 requires all investments to be reported at their fair market value (rather than book value) and investment income to be adjusted to reflect the difference between the fair market and book value of investments as either a capital gain or loss. The financial data derived from the financial statements of the 1943 Fund for FY 1996 through FY 1997 and presented in the tables below have been adjusted to reflect the impact of GASB 31 on investments and investment income so as to make such data consistent with the accounting procedures used in preparing the Department's financial statements for FY 1998 and thereafter.

The impact of GASB 31 adjustments over the five-year period reflected in the tables below (including FY 2000) are a cumulative increase of \$15,156,000 in the deficiency of revenues over expenses and cumulative decrease of the same amount in retained earnings.

**SELECTED FINANCIAL DATA OF THE 1943 FUND**  
(Dollars in Thousands)

	<u>June 30, 2000</u>	<u>June 30, 1999</u>	<u>June 30, 1998</u>	<u>Restated June 30, 1997</u>	<u>Restated June 30, 1996</u>
<b>ASSETS AND LIABILITIES RELATED TO LENDING AND FINANCING ACTIVITIES:</b>					
<b>CASH AND INVESTMENTS</b>					
Cash and amounts on Deposit in SMIF*	\$226,076	\$239,979	\$325,321	\$317,178	\$295,140
Guaranteed Investment Contracts	562,380	890,692	938,888	365,542	475,744
Treasury Securities	112,107	183,645	187,851	347,214	363,426
Total	<u>900,563</u>	<u>1,314,316</u>	<u>1,452,060</u>	<u>1,029,934</u>	<u>1,134,310</u>
<b>DUE FROM VETERANS DEBENTURE REVENUE FUND</b>	33,847	22,471	12,686	86,279	137,141
<b>OTHER CURRENT ASSETS</b>	30,903	18,335	13,755	22,596	26,191
<b>NET OTHER NON-CURRENT ASSETS</b>	33,255	33,262	36,406	15,123	15,824
<b>CONTRACTS OF PURCHASE</b>					
Performing Contracts	2,418,292	2,040,587	2,035,879	2,154,142	2,231,994
Non Performing Contracts	16,764	28,669	62,872	75,038	74,268
Total	<u>2,435,056</u>	<u>2,069,256</u>	<u>2,098,751</u>	<u>2,229,180</u>	<u>2,306,262</u>
Allowance For Contract Losses	(19,676)	(21,263)	(22,005)	(26,412)	(15,801)
Reduction of REO to Fair Value	(3,050)	(8,104)	(19,003)	(24,003)	(17,113)
Total	<u>(22,726)</u>	<u>(29,367)</u>	<u>(41,008)</u>	<u>(50,415)</u>	<u>(32,914)</u>
<b>BONDS PAYABLE</b>					
General Obligation Bonds	(2,528,330)	(2,687,390)	(2,947,165)	(2,632,045)	(2,812,810)
Revenue Bonds	(505,815)	(404,215)	(275,055)	(327,580)	(374,975)
Total	<u>(3,034,145)</u>	<u>(3,091,605)</u>	<u>(3,222,220)</u>	<u>(2,959,625)</u>	<u>(3,187,785)</u>
<b>OTHER CURRENT LIABILITIES</b>	(93,298)	(56,369)	(58,458)	(80,502)	(86,716)
<b>Net Lending &amp; Financing Activities Assets</b>	<u>283,455</u>	<u>280,299</u>	<u>291,972</u>	<u>292,570</u>	<u>312,313</u>
<b>ASSETS AND LIABILITIES RELATED TO INSURANCE ACTIVITIES:</b>					
<b>LIFE AND DISABILITY COVERAGE</b>					
Deposits with Insurance Administrators	23,010	30,573	40,823	48,762	56,843
Insurance Reserves and Claims Payable	(31,642)	(39,751)	(53,185)	(65,828)	(78,246)
Total	<u>(8,632)</u>	<u>(9,178)</u>	<u>(12,362)</u>	<u>(17,066)</u>	<u>(21,403)</u>
<b>FIRE AND HAZARD COVERAGE</b>					
Net Insurance Reserves and Claims Payable	(1,386)	(1,552)	(1,209)	(1,405)	(2,744)
<b>Net Insurance Activities Liabilities</b>	<u>(10,018)</u>	<u>(10,730)</u>	<u>(13,571)</u>	<u>(18,471)</u>	<u>(24,147)</u>
<b>RETAINED EARNINGS</b>	<u>\$ 273,437</u>	<u>\$ 269,569</u>	<u>\$ 278,401</u>	<u>\$ 274,099</u>	<u>\$ 288,166</u>
<b>SUMMARY INFORMATION</b>					
Total Assets	\$3,411,000	\$3,435,000	\$3,587,000	\$3,377,000	\$3,639,000
Total Liabilities	\$3,137,000	\$3,166,000	\$3,309,000	\$3,103,000	\$3,351,000
Total Number of Contracts of Purchase	33,440	32,243	35,906	39,343	42,650

\*Surplus Money Investment Fund

**SELECTED FINANCIAL DATA OF THE 1943 FUND**  
(Dollars in Thousands)

	<u>June 30, 2000</u>	<u>June 30, 1999</u>	<u>June 30, 1998</u>	<u>Restated June 30, 1997</u>	<u>Restated June 30, 1996</u>
<b>NET INCOME FROM LENDING AND FINANCING ACTIVITIES:</b>					
<b>INTEREST INCOME</b>					
Interest on Contracts	\$150,213	\$139,839	\$162,086	\$175,186	\$182,636
Interest on Investments	69,471	75,292	74,077	67,373	79,510
Transfers of Interest From Veterans Debenture Revenue Fund	<u>1,476</u>	<u>887</u>	<u>3,317</u>	<u>10,843</u>	<u>11,144</u>
Total	<u>221,160</u>	<u>216,018</u>	<u>239,480</u>	<u>253,402</u>	<u>273,290</u>
<b>BOND INTEREST EXPENSE</b>	<u>(193,495)</u>	<u>(201,772)</u>	<u>(218,757)</u>	<u>(230,871)</u>	<u>(245,971)</u>
<b>Net Interest Income</b>	<u><u>27,665</u></u>	<u><u>14,246</u></u>	<u><u>20,723</u></u>	<u><u>22,531</u></u>	<u><u>27,319</u></u>
<b>RESERVE FOR RATE STABILIZATION</b>	(5,700)				
GASB 31 ADJUSTMENT	479	(6,897)	(4,578)	8,420	(12,580)
GAIN ON SALE OF SECURITIES	270	2,351	13,460		
RESTRUCTURING EXPENSES	<u>(2,629)</u>	<u>(6,342)</u>	<u>(3,068)</u>		
	<u><u>(7,580)</u></u>	<u><u>(10,888)</u></u>	<u><u>5,814</u></u>	<u><u>8,420</u></u>	<u><u>(12,580)</u></u>
<b>CONTRACTS OF PURCHASE</b>					
PMI	(86)	(2,330)	(1,551)		
Net loss on Sale of REO'S	(2,683)	(3,886)	(3,128)	(8,309)	(5,510)
(Increase) Decrease in Allowance for Contract Losses	<u>6,641</u>	<u>3,343</u>	<u>(1,312)</u>	<u>(22,677)</u>	<u>(5,515)</u>
Total	<u>3,872</u>	<u>(2,873)</u>	<u>(5,991)</u>	<u>(30,986)</u>	<u>(11,025)</u>
<b>Net Lending/Financing Activities Income (Expense)</b>	<u><u>23,957</u></u>	<u><u>485</u></u>	<u><u>20,546</u></u>	<u><u>(35)</u></u>	<u><u>3,714</u></u>
<b>NET INCOME FROM ADMINISTRATIVE ACTIVITIES</b>					
Operating Revenues	5,779	3,826	1,891	2,290	1,769
Operating Expenses	<u>(23,902)</u>	<u>(19,543)</u>	<u>(20,381)</u>	<u>(20,218)</u>	<u>(18,810)</u>
<b>Net Administrative Activities Expense</b>	<u><u>(18,123)</u></u>	<u><u>(15,717)</u></u>	<u><u>(18,490)</u></u>	<u><u>(17,928)</u></u>	<u><u>(17,041)</u></u>
<b>NET INCOME FROM INSURANCE ACTIVITIES</b>					
Life and Disability Coverage	(3,374)	5,290	160	3,570	(5,424)
Fire and Hazard Coverage	<u>1,408</u>	<u>1,110</u>	<u>2,086</u>	<u>326</u>	<u>(538)</u>
<b>Net Insurance Activities Income (Expense)</b>	<u><u>(1,966)</u></u>	<u><u>6,400</u></u>	<u><u>2,246</u></u>	<u><u>3,896</u></u>	<u><u>(5,962)</u></u>
<b>TOTAL EXCESS (DEFICIENCY) OF REVENUES AND TRANSFERS OVER EXPENSES</b>	<u><u>3,868</u></u>	<u><u>(8,832)</u></u>	<u><u>4,302</u></u>	<u><u>(14,067)</u></u>	<u><u>(19,289)</u></u>
<b>RETAINED EARNINGS</b>	<u><u>\$ 273,437</u></u>	<u><u>\$ 269,569</u></u>	<u><u>\$ 278,401</u></u>	<u><u>\$ 274,099</u></u>	<u><u>\$ 288,166</u></u>

### *Department's Discussion of Financial Data*

Certain aspects of the Department's financial results as presented in the five-year tables are discussed below. While the financial results for FY 2000 are largely positive, the continued implementation of the Department's programmatic and financial management revisions may result in losses in future years.

*Overview.* Although the Program has experienced losses during three of the last five years, the impact of significant programmatic and financial management changes implemented beginning in FY 1996 is evidenced in the FY 2000 financial results. Since FY 1996, the Department has (a) expanded eligibility requirements for borrowers and created competitive Program terms to stimulate growth of its portfolio of Contracts of Purchase, (b) established a flexible interest rate setting mechanism to increase its interest rate spread on new Contracts of Purchase, (c) secured primary mortgage insurance for over \$700,000,000 of outstanding Contracts of Purchase previously self-insured by the 1943 Fund, (d) implemented requirements for guarantees by the United States Department of Veterans Affairs or other primary mortgage insurance on most newly originated high loan-to-value ratio ("LTV") Contracts of Purchase, (e) converted a majority of its life and disability coverage plan from a self-insured program to third-party insurance, and (f) revised Contract of Purchase underwriting and servicing procedures in ways intended to improve the performance of the Contracts of Purchase portfolio, including more aggressive disposition of its inventory of repossessed properties ("REOs") to reduce carry and exposure on previously defaulted Contracts of Purchase.

The 1943 Fund, which is the sole operating fund for the Program, reflects a retained earnings balance of \$273,437,000 as of June 30, 2000, which is substantially equivalent to the Department's fund balance prior to the programmatic and financial restructuring implemented beginning in FY 1997. Although retained earnings have decreased in three of the last five years, the overall asset-to-liability ratio for the 1943 Fund has remained nearly constant at approximately 108% during the same period. The excess of revenues over expenses for the Program for FY 2000 was \$3,868,000 and represents a \$12,700,000 improvement over the FY 1999 loss of \$8,832,000. In FY 2000, the 1943 Fund realized a significant improvement in net interest income. Significant reductions occurred in costs for Contract of Purchase losses and insurance, as well as certain non-cash charges for GASB 31 accounting charges and amortization of restructuring expenses. *However*, these reductions were offset in part by increased administrative costs and reserves for insurance.

*Assets and Liabilities.* From FY 1996 to FY 1999 the Program experienced a declining balance of outstanding Contracts of Purchase (as measured at fiscal year-end) due to fluctuating levels of new originations and prepayments. However, from FY 1999 to FY 2000, the outstanding balance of Contracts of Purchase increased by 18% from \$2,069,256,000 to \$2,435,056,000 which is the largest Contracts of Purchase balance since FY 1993. Prior to FY 2000, substantially all newly originated Contracts of Purchase were funded at the same interest rate as outstanding Contracts of Purchase (6.95%). As a part of the Department's continued implementation of Program revisions, beginning January 1, 1999 through FY 2000, the reservation interest rates on Contracts of Purchase were 5.95% for Contracts of Purchase financed using Qualified Mortgage Bond Proceeds, and 6.65% for all other Contracts of Purchase. As a result of this revised interest rate policy, as well as expanded Program eligibility requirements, the amount of Contracts of Purchase funded during FY 2000 was \$610,724,000, an increase of 139% over Contracts of Purchase funded during FY 1999 of \$255,534,000. These new Contracts of Purchase were funded from multiple sources consisting of (a) \$220 million of Revenue Bond and Veteran G.O. Bond proceeds, (b) \$244 million of recycled Contracts of Purchase principal receipts and (c) \$146 million of other invested funds. In addition, during FY 2000, prepayments of Contracts of Purchase decreased by

25% from \$183,776,000 in FY 1999 to \$138,401,000 in FY 2000. Going forward, the Department's Contract of Purchase interest-rate setting procedures permit it to establish the interest rates on newly originated Contracts of Purchase at rates that more closely reflect its current cost of funds.

During FY 2000, cash and investments declined by \$413,753,000. Most of this reduction is due to the application of such funds to finance new Contracts of Purchase. The balance of this reduction is the result of such funds being applied to debt retirement.

In aggregate, total Program assets have declined 6.3% since FY 1996. The debt structure of the Program, *however*, accommodated this downward trend in assets through a series of bond redemptions which resulted in a similar reduction in the principal amount of bonds outstanding.

Beginning in FY 1996, the Department moved aggressively to repossess properties of canceled Contracts of Purchase and dispose of its REOs which had increased significantly in the early 1990's due to the decline in real estate values and overall economic conditions in certain California housing sub-markets. As a result, the principal balance of Contracts of Purchase classified as REOs decreased by \$11,905,000 from June 30, 1999 to June 30, 2000. The aggregate reduction in Contracts of Purchase classified as REOs from June 30, 1997 to June 30, 2000 is \$58,274,000. Due to the reduced intake of new REOs and ongoing property sales, non-performing Contracts of Purchase at June 30, 2000 represented 0.7% of the Department's portfolio – the lowest level since the start of real estate market difficulties in the early 1990's.

In conjunction with this effort, the Department periodically reassesses the adequacy of its loss reserves. During FY 2000, the Department's loss allowance was reduced by \$6,641,000 due to the adequacy of reserves funded in prior years, improvement in the overall performance of the Contracts of Purchase portfolio and insurance coverage. Accumulated loss reserves decreased \$27,689,000 or 54.9% over the last three years. The remaining loss reserve of \$22,726,000 at June 30, 2000, together with the Department's (a) purchase of primary mortgage insurance during FY 1998 with respect to certain outstanding Contracts of Purchase with high LTVs, (b) imposition of USDVA guarantees for certain high LTV Contracts of Purchase originated beginning in April 1998, and (c) imposition of additional primary mortgage insurance provided by Radian for certain newly originated high LTV Contracts of Purchase which are not eligible for USDVA guarantees, are intended to provide for future potential REO losses. (See "THE PROGRAM – Loan Insurance" in this APPENDIX B).

In FY 2000 the Department continued to reduce its exposure to market volatility with continued reduction of a portfolio of Treasury securities (which are now entirely liquidated) and increased use of investment contracts for various revenue accounts. See EXHIBIT 2 to this APPENDIX B - "CERTAIN DEPARTMENTAL FINANCIAL INFORMATION AND OPERATING DATA."

The Department continued the addition of long-term Revenue Bonds into its overall debt structure with such bonds making up 16.6% of all outstanding Veterans G.O. Bonds and Revenue Bonds – the highest level since 1995. The growth rate of additional Revenue Bonds should decrease as a result of the substantial completion of the Department's pre-Ullman (defined herein) refunding efforts, which provide Unrestricted Moneys to finance Contracts of Purchase for certain veterans. In addition, during FY 2000, the Department continued to reduce the impact of non-callable Veterans G.O. Bonds issued in the early 1980's. By April 1, 2001, approximately \$659,000,000 of such bonds remained outstanding with a remaining average life of only five years and an average interest cost of approximately 9.0%. This represented 23% of total Veterans G.O. Bonds and Revenue Bonds outstanding.

Effective June 1, 1996, the Department's self-insured life and disability coverage plan was transferred to a fully-insured interim plan underwritten by an outside commercial insurer except for that portion of the Program covering existing claims of disabled Contract of Purchase holders for whom the Department continues to provide coverage. For those Contract of Purchase holders for whom the Department continues to provide self-insured coverage, loss reserves for such obligations have been actuarially based and have been reduced in FY 2000 based on the characteristics of the Department's Contracts of Purchase portfolio and the amount of funded reserves. Approximately 73% of such loss reserves are funded and maintained under a third party administrator agreement. The remaining amount is unfunded, but reserved in the form of an accrued liability. Effective February 1, 1998, the interim plan was replaced after a competitive bidding process, by a replacement, long-term life insurance and disability plan provided by the same commercial insurer. See "THE PROGRAM – PROPERTY AND LIFE AND DISABILITY INSURANCE" in this APPENDIX B.

*Income and Expenses.* The Program's FY 2000 net interest income (total interest income less bond interest expense) of \$27,665,000 was \$13,419,000 greater than FY 1999. However, this amount includes a non-recurring item of approximately \$7,300,000 for recognition of investment earnings which were received on refunding escrows established in prior years. Applying an adjusted net interest income amount of \$20,365,000 to exclude this non-recurring item, results in net interest margin (net interest income divided by average interest-bearing assets) of 0.60%. This increase in net interest margin from 0.41% in FY 1999 reflects (a) the substantial conversion of lower yielding investments to higher yielding Contracts of Purchase and (b) reduced interest expense as high coupon non-callable bonds matured. During FY 2000, interest expense on non-callable debt exceeded interest income on related Contracts of Purchase by approximately \$15,000,000.

In addition, income was positively affected in FY 2000 by a \$270,000 increase in the effect of realized and unrealized gains on securities due to changes in market value and a \$479,000 increase to reflect GASB 31 accounting requirements. These effects were minimal compared to prior years, due to the Department's relatively smaller and shorter maturity investment portfolio. During FY 2000 income was negatively affected by continued amortization of \$2,629,000 of the financing and redemption costs relating to the issuance of and refunding of bonds, which are expected to represent recurring expenses for future years' operations.

In FY 2000, the Department achieved a net gain in its real estate risk activities – the first year without a loss since 1992. This resulted from several factors, including (a) a reduction in the Department's cost of private mortgage insurance as it implemented a policy of veteran reimbursement of premium costs, (b) a reduction in the net loss on the disposition of REOs and (c) a reduced allowance for Contract of Purchase losses due to improved Contracts of Purchase performance and increased insurance coverage.

In FY 2000 there was no significant impact on the Department's insurance activities from the existing life and disability coverage plan or fire and hazard coverage plan. Income was reduced by \$5,700,000 to cover potential premium increases and provide additional benefits to certain veterans adversely affected by termination of eligibility under the Department's prior self-insured life and disability plan.

Program administrative operating expenses in FY 2000 were \$23,902,000, an increase of 22.3% from FY 1999. This increase was largely due to the Department's implementation of a new information system relating to the Program and the Veterans G.O. Bonds and Revenue Bonds and increased staffing costs to cover incremental Contracts of Purchase origination activity. After taking into account a

\$1,953,000 increase in operating revenue, net administrative operating expenses increased 15.3% over FY 1999 results.

The Financial Statements of the 1943 Fund for Fiscal Years 2000 and 1999 and Independent Auditors' Report can be found in EXHIBIT 1 to this APPENDIX B. "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA" can be found in EXHIBIT 2 to this APPENDIX B.

### **External Reviews of the Program**

The Program has been the subject of several external reviews by the executive and legislative branches of State government, and one such external review is in process. The focus of these reviews has been various public policy concerns relating to the Program. A summary of certain of these reviews is presented below.

#### *The Legislative Analyst's Office of the State of California*

The Legislative Analyst's Office of the State of California (the "LAO") issued a 1998 report entitled "Rethinking the Cal-Vet Loan Program (the "1998 Report") and an analysis of the then-proposed Governor's Budget 1999/2000, which analysis included a discussion of the Department (the "1999 Report" and, together with the 1998 Report, the "1998/99 LAO Reports.") The stated purpose of the LAO is to provide analysis and nonpartisan advice to the California Legislature on fiscal and policy issues. The LAO is overseen by the Joint Legislative Budget Committee, a 14-member bipartisan committee composed of an equal number of State Assembly and State Senate members.

In the 1998/99 LAO Reports, the LAO analyzed the historical and recent financial performance and lending activities of the Department and made various recommendations. The 1998/99 LAO Reports described the financial losses experienced by the Department, the increasing rate of repayment of Contracts of Purchase, and the decreased lending activity in recent years. The 1998/99 LAO Reports were issued before the impact of the Department's recent programmatic changes had been realized.

In his proposed budget for Fiscal Year 1999-2000, Governor Davis listed several steps intended to improve the operation of State programs for veterans. Those most relevant to the Program are (a) appointment of an inspector general or internal auditor for the Department, (b) a request to the Bureau of State Audits (the "BSA") to conduct a fiscal and program compliance audit of the Program, and (c) direction to the Secretary of Veterans Affairs to report to the Governor on the need for further restructuring of the Program and on ways that the "surplus funds in the home program" might be redirected to other pressing needs of veterans. As directed, the Department submitted a report to the Governor which, among other things, advised the Governor that, in its view, there are no "surplus" funds in the home program as the term implies. No new gubernatorial directives have been issued to the Department.

On February 17, 2000, the LAO issued an analysis of the proposed Governor's Budget for Fiscal Year 2000-01, which analysis included a discussion of the Department. The report recognized that the administrative costs of the Program are not part of the State budget, but recommended that the Department report to the State Legislature during budget hearings on the reasons for certain cost increases and the steps it is taking to reduce such costs. The LAO did not address the Program, Veterans G.O. Bonds, Revenue Bonds, or the 1943 Fund in its report on the Governor's Budget for Fiscal Year 2001-2002.

### *Bureau of State Audits*

On January 5, 2000, the Legislature directed the BSA to conduct an audit of the California Veterans Farm and Home Loan Purchase Program (loan program). The legislative request called for assessment of, among other things, whether the Department achieves its mission with its loan programs, the financial condition of the loan program and the reasonableness and appropriateness of expenditures, the relationship of the Department's lending standards to those in the lending industry and whether those standards are adhered to in the Department's lending process, and the demographics of eligible war veterans and the impact thereof on the loan program's viability.

On May 25, 2000, the BSA released an audit report concluding that the loan program will substantially lose its ability to offer low-cost home loans to veterans beyond the next decade due to the restrictive eligibility requirements attributed to certain program funding and the limited availability of other funding sources. The BSA further concluded that the Department was eroding loan program funds due to insufficient budget controls, inefficient and inconsistent loan operations and by charges to the loan program for unrelated administrative positions and costs. Finally, the BSA concluded, based in part upon its conclusion that the Department's testing of its integrated information system was incomplete, that the Department will need to spend more time and money to ensure that its integrated information system provides necessary, reliable program and financial information.

In a written response to the May 25, 2000 report, the Department disagreed with certain conclusions of the BSA and expressed the belief that it has already addressed certain report findings. In particular, the Department projects that the loan program will be attractive to a much higher percentage of eligible veterans than estimated by the BSA. Further, the Department believes that additional loan sources can be created through additional allocations of Qualified Mortgage Bonds loans and the blending of Unrestricted Moneys tax-exempt bonds with taxable bonds. In addition, the Department contends that steps have already been taken to ensure that information systems are properly administered and that loan program data and assets are adequately safeguarded. As part of the Department's plan to implement corrective action in certain areas identified by the BSA, the Department, upon the recommendations of an outside consultant, has undertaken steps designed to ensure proper allocation of its direct and indirect administrative costs to the loan program.

On March 28, 2001, the BSA released an audit report prepared in response to the Legislature's direction for an audit of the Department's life and disability insurance program. In its report, the BSA concluded that changes made to the Department's life and disability insurance program in 1996 reduced the Department's financial liabilities but also reduced the insurance program's benefits for veterans. The analysis in the audit report divides the Department's insurance program into two principal parts: the self-funded plan and the commercial plan. The self-funded plan is closed to new participants and covers veterans who were disabled when the Department converted in 1996 to the commercial plan. The commercial plan includes veterans in the Department's self-funded mandatory plan which preceded the commercial insurance and veterans who obtained their Contracts of Purchase after implementation of the commercial insurance. The BSA concluded that the self-funded portion of the insurance program is currently underfunded. In addition, the BSA concluded that the short-term nature of commercial insurance policies, the high cost of a self-funded insurance program, the scarcity of available funding sources, and the unpredictability of future participation in the loan and insurance programs impose difficulties in forecasting the long-term costs of the insurance program. The BSA also concluded that the Department's administration of the insurance program contains flaws that weaken the Department's ability to manage the insurance program and safeguard assets.



The BSA urged the Department to develop a long-term strategy to address its insurance program. The BSA suggested that the Department, in deciding the future of the insurance program, consider the above-listed factors in forecasting costs of the program. The BSA further suggested that the Department could increase funding for the insurance program using a limited amount of loan program funds that would not adversely affect the Department's ability to meet bond payments, through modest increases in premiums, and through savings in the operational costs for the loan program. In addition, the BSA suggested that the Department consider discontinuing the insurance program for certain veterans who are not currently disabled. Finally, the BSA suggested that the Department follow State guidelines to improve the administration of the insurance program.

In a written response to a draft of the audit report, the Department stated that sufficient funds to pay liabilities under the self-funded plan are made available as needed and that the current cash reserves are more than adequate for such purposes for the immediate future. The Department agreed with the BSA's suggestion of factors it should consider when deciding the future of the insurance program, but noted that its primary responsibility is to ensure the health of the Program overall. Finally, the Department asserted that it has already taken steps to conform its administration of the insurance program to State guidelines. See "THE PROGRAM – Property and Life and Disability Insurance" and EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA" herein.

Copies of the 1998/99 LAO Reports and the May 25, 2000 and March 28, 2001 reports of the BSA, including the Department's responses thereto, are available from the Department upon request.

The financial performance of and loan origination activities of the Department are discussed elsewhere in this Official Statement. The Department does not believe that either termination of loan originations or use of Department moneys to fund other programs, if either or both of such actions were implemented, would have an adverse impact on the Department's ability to pay scheduled principal of and interest on any Veterans G.O. Bonds or Revenue Bonds. While the Legislature could enact any or all of the recommendations in the 1998/99 LAO Reports or any recommendations of the BSA, use of moneys in the 1943 Fund for veterans benefits outside of the Program may be subject to approval by the electorate of the State and may also be subject to other legal restrictions. See "AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS – Security For and Payment of Veterans G.O. Bonds," APPENDIX B – "THE 1943 FUND – Selected Financial Data of the 1943 Fund and Department's Discussion," EXHIBIT 1 to this APPENDIX B – "FINANCIAL STATEMENTS OF THE 1943 FUND FOR FISCAL YEARS 2000 AND 1999 AND INDEPENDENT AUDITOR'S REPORT" and EXHIBIT 2 to this APPENDIX B – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA" herein.

### **Debbs Litigation**

On June 25, 1996, the Department was served with a summons and complaint initiating a lawsuit entitled *John L. Debbs, et al. v. California Department of Veterans Affairs, et al.* (Superior Court of California, County of Los Angeles, Case No. BC 151476). The third amended complaint alleges "fraudulent concealment, declaratory relief, injunctive relief, and damages for monies unlawfully taken from the California Veterans Farm and Home Life and Disability Protection Plan." Plaintiff claims that in 1983, when the Department canceled its contracts with two life insurance companies then responsible for underwriting the life and disability programs, an amount exceeding \$100 million in insurance reserves, which was returned to the Department, thereafter was illegally expended by the Department, and that certain transfers from the life and disability reserves to the 1943 Fund were unlawful. The complaint seeks, among other things, a determination that premiums under the life and disability program be reduced to prior levels and the return of the moneys, plus interest, from the 1943 Fund to the life and disability reserves. Plaintiffs failed in their attempts to obtain a preliminary injunction and temporary restraining

order, seeking to stop the Department from foreclosing Contracts of Purchase of veterans who have disability claims under the Department's current disability insurance program. Plaintiffs are appealing the denial of the preliminary injunction. In July 1998, the court certified the case as a class action and ordered Plaintiffs to provide notice to the class by December 27, 1999. At a hearing on December 5, 2000, the class was decertified because the class members had not been notified. That decision has been appealed, and the record on appeal is to be filed by the appellants on or before April 16, 2001. Meanwhile, the case as to the original named plaintiffs is proceeding, and a status conference has been scheduled for July 16, 2001.

The Department is vigorously opposing the lawsuit. While the outcome of any litigation cannot be predicted with certainty, the Department expects ultimately to prevail in this matter. Even if the Plaintiffs should prevail in this matter, the Department does not expect such an outcome to affect timely payment of debt service on the Offered Veterans G.O. Bonds.

### **Excess Revenues**

The Department has covenanted with the holders of its Revenue Bonds to apply Revenues received with respect to Contracts of Purchase, after payment or reimbursement of debt service on Veterans G.O. Bonds, in a specified order of priority. For this purpose, "Revenues" means all moneys received by or on behalf of the Department representing (i) principal and interest payments on the Contracts of Purchase including all prepayments representing the same and all prepayment premiums or penalties received by or on behalf of the Department in respect to the Contracts of Purchase, (ii) interest earnings received on the investment of amounts to the extent deposited in the revenue account established under the Revenue Bond Resolution, (iii) amounts transferred to the revenue account from the bond reserve account or the loan loss amount established under the Revenue Bond Resolution, and (iv) any other amounts payable by parties executing Contracts of Purchase or private participants in the Program or related to recoveries on defaulted Contracts of Purchase, including origination and commitment fees, servicing acquisition fees, liquidation proceeds, and insurance proceeds, *except* to the extent not included as "Revenues" pursuant to the provisions of any resolution authorizing the issuance of a series of Revenue Bonds.

The Department has covenanted with the Revenue Bond holders to administer the 1943 Fund and the Program and perform its obligations to such holders in accordance in all material respects with the then-current Program Operating Procedures. The Program Operating Procedures are operating policies of the Department governing the discretionary activities of the Department under the Revenue Bond Resolution. The Department may amend the Program Operating Procedures. The Program Operating Procedures will affect the Excess Revenues that will become available to redeem the Offered Veterans G.O. Bonds.

The Department has covenanted with the Revenue Bond holders to apply Revenues in the following order, after paying, or reimbursing for payments of, debt service on Veterans G.O. Bonds, including the costs of liquidity and credit enhancement facilities related thereto, and setting aside moneys as required under the Federal Tax Code to preserve the tax-exempt status of certain Veterans G.O. Bonds and Revenue Bonds, (1) to pay debt service on Revenue Bonds, (2) to pay the costs associated with liquidity and credit enhancement facilities, if any, for Revenue Bonds, (3) to replenish certain reserve funds established for the Revenue Bonds, (4) if the Department elects, to pay Department expenses, (5) to set aside a monthly accrual of Veterans G.O. Bond debt service, (6) if the Department elects, to finance Contracts of Purchase, and (7) with respect to Excess Revenues and certain tax restricted moneys, to redeem Veterans G.O. Bonds, including the Offered Veterans G.O. Bonds, and Revenue Bonds. For such purposes:

(a) "Excess Revenues" means, as of any date of calculation, Revenues in excess of Accrued Debt Service;

(b) "Accrued Debt Service" means, as of any date of determination and, as the context requires, with respect to all Revenue Bonds and Veterans G.O. Bonds (including the Offered Veterans G.O. Bonds), the sum of:

(i) the aggregate amount of scheduled interest and principal (*except* to the extent otherwise to be redeemed pursuant to clause (ii) or (iii) below) to become due after such date but on or before the end of the current debt service year, less the product of (x) the number of whole months remaining in the current debt service year and (y) the Monthly Debt Service Requirement;

(ii) the redemption price of bonds for which notice of redemption has been issued, provided such redemption price is to be paid from amounts on deposit in the revenue account created under the Revenue Bond Resolution; and

(iii) the redemption price of bonds that the Department will be obligated to redeem prior to the end of the next succeeding debt service year, to the extent that such obligation arises on account of amounts on deposit in such revenue accounts; and

(c) "Monthly Debt Service Requirements" means, as of any date of determination, one-twelfth of the aggregate amount of scheduled interest and principal to become due during the debt service year in which such date falls, as computed on the first day of such debt service year.

#### **Maintenance of Fund Parity**

The Revenue Bond Resolution requires the Department to calculate "Fund Parity" at least annually. "Fund Parity" means (a) an amount equal to the difference between (i) all assets in the 1943 Fund and in the accounts established under the Revenue Bond Resolution, and (ii) the principal amount of all Revenue Bonds and Veterans G.O. Bonds outstanding (plus accrued interest) reduced by (b) defined allowances and reserves for loss coverage on Contracts of Purchase and life and disability coverage on persons obligated under Contracts of Purchase. If any such calculation shall not reflect that Fund Parity at least equals the percentage required by the Revenue Bond Resolution, the Department may be required to expend Excess Revenues to redeem Revenue Bonds until its recalculations of Fund Parity meet the test required by the Revenue Bond Resolution.

**VETERANS FARM AND HOME  
BUILDING FUND OF 1943,  
DEPARTMENT OF VETERANS  
AFFAIRS, STATE OF CALIFORNIA**

**Financial Statements for the Years Ended June 30,  
2000 and 1999 and Independent Auditors' Report**

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## INDEPENDENT AUDITORS' REPORT

To the California Veterans Board  
State of California  
Sacramento, California

We have audited the accompanying balance sheets of the Veterans Farm and Home Building Fund (Fund) of 1943, which is administered by the Department of Veterans Affairs of the State of California (Department) as of June 30, 2000 and 1999, and the related statements of revenues, expenses and changes in retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Veterans Farm and Home Building Fund of 1943, and are not intended to present the financial position of the Department of Veterans Affairs of the State of California and the results of its operations and cash flows of its proprietary fund types.

In our opinion, such financial statements referred to above present fairly, in all material respects, the financial position of the Veterans Farm and Home Building Fund of 1943, Department of Veterans Affairs of the State of California as of June 30, 2000 and 1999, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*Deloitte + Touche LLP*

October 27, 2000

**VETERANS FARM AND HOME BUILDING FUND OF 1943,  
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA**

**BALANCE SHEETS**

**JUNE 30, 2000 AND 1999 (in thousands)**

	<b>2000</b>	<b>1999</b>
<b>ASSETS</b>		
Investments		
Unrestricted	\$ 279,662	\$ 464,965
Restricted	620,901	849,351
Insurance administrators	<u>24,860</u>	<u>32,423</u>
Total investments	925,423	1,346,739
Receivables under contracts of sale, net of allowance for uncollectible contracts of \$19,676 in 2000 and \$21,263 in 1999	2,398,616	2,008,813
Due from Veterans Debenture Revenue Fund	33,847	22,471
Interest receivable		
Contracts of sale	15,455	10,511
State of California's Surplus Money Investment Fund	3,528	3,998
Other investments	4,968	8,214
Due from other funds	6,952	6,123
Other real estate owned, net of allowance for losses of \$3,050 in 2000 and \$8,104 in 1999	13,714	20,565
Land, improvements and equipment, net of accumulated depreciation of \$8,080 in 2000 and \$6,986 in 1999	7,288	7,578
Other	<u>933</u>	<u>466</u>
<b>TOTAL ASSETS</b>	<b><u>\$3,410,724</u></b>	<b><u>\$3,435,478</u></b>
<b>LIABILITIES AND RETAINED EARNINGS</b>		
<b>LIABILITIES</b>		
Cash overdraft due to State Treasury	\$ 17,340	\$ 6,393
Accrued interest and other liabilities	71,785	49,976
Bonds payable - net	3,009,111	3,066,387
Insurance claims payable and loss reserves	<u>39,051</u>	<u>43,153</u>
Total liabilities	3,137,287	3,165,909
<b>RETAINED EARNINGS</b>	<u>273,437</u>	<u>269,569</u>
<b>TOTAL LIABILITIES AND RETAINED EARNINGS</b>	<b><u>\$3,410,724</u></b>	<b><u>\$3,435,478</u></b>

See notes to financial statements

**VETERANS FARM AND HOME BUILDING FUND OF 1943,  
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA**

**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS  
YEARS ENDED JUNE 30, 2000 AND 1999 (in thousands)**

	2000	1999
<b>PROGRAM OPERATIONS:</b>		
Interest revenues:		
Contracts of sale of properties	\$ 150,213	\$ 139,839
Investments and other	71,607	74,079
Transfers of revenue from Veterans Debenture Revenue Fund	<u>1,476</u>	<u>887</u>
Total program operations revenues	223,296	214,805
Expenses		
Interest expense	193,495	201,772
Reversal of allowance for uncollectible contracts	<u>(6,641)</u>	<u>(3,343)</u>
Total program operations expenses	<u>186,854</u>	<u>198,429</u>
Excess of program operations revenues over program operations expenses	<u>36,442</u>	<u>16,376</u>
<b>PROGRAM ADMINISTRATION:</b>		
Revenues		
Loan servicing fees	4,784	3,261
Other income	995	565
Excess of amounts charged to contract holders over fire and hazard insurance claims and expenses and changes in insurance reserves	1,408	1,110
Excess of amounts charged to contract holders and changes in insurance reserves over self-insured life and disability claims and expenses	<u>          </u>	<u>1,957</u>
Total program administration revenues	7,187	6,893
Expenses		
Payroll and related costs	12,241	11,171
General and administrative expenses	20,076	17,044
Excess of self-insured life and disability insurance claims and expenses and changes in insurance reserves over amounts charged to contract holders	<u>4,761</u>	<u>          </u>
Total program administration expenses	<u>37,078</u>	<u>28,215</u>
Excess of program administration expenses over program administration revenues	<u>(29,891)</u>	<u>(21,322)</u>
<b>LOSS ON SALE OF REPOSSESSED PROPERTY</b>	<u>(2,683)</u>	<u>(3,886)</u>
<b>EXCESS (DEFICIENCY) OF REVENUES OVER EXPENSES</b>	3,868	(8,832)
<b>RETAINED EARNINGS:</b>		
Beginning of year	<u>269,569</u>	<u>278,401</u>
End of year	<u>\$ 273,437</u>	<u>\$ 269,569</u>

See notes to financial statements



# VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

## STATEMENTS OF CASH FLOWS

**YEARS ENDED JUNE 30, 2000 AND 1999 (in thousands)**

	2000	1999
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Excess (deficiency) of revenues over expenses	\$ 3,868	\$ (8,832)
Adjustments to reconcile to net cash used by operating activities		
Amortization of bond premiums, discounts and issuance costs	1,855	3,207
Depreciation expense	1,094	1,042
Loss on sale of repossessed property	2,683	3,886
Effect of changes in assets and liabilities		
Interest receivable - State of California's Surplus Money Investment Fund	470	(897)
Interest receivable - other investments	3,246	1,394
Interest receivable - contracts of sale	(4,944)	1,234
Due from other funds	(829)	(5,077)
Other real estate owned	4,168	19,418
Other assets	(467)	(374)
Accrued interest and other liabilities	21,809	(8,482)
Insurance claims payable and loss reserves	(4,102)	(13,091)
Net cash provided (used) by operating activities	<u>28,851</u>	<u>(6,572)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Net increase in receivables under contracts of sale	(389,803)	(6,684)
Net decrease in investment securities	421,316	141,441
Purchase of land, improvements and equipment	(804)	
Net cash provided by investing activities	<u>30,709</u>	<u>134,757</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Increase in cash overdraft due to State Treasury	10,947	6,393
Proceeds from sales of bonds	243,700	591,755
Maturities of bonds payable	(162,991)	(82,235)
Early redemption of bonds payable	(139,840)	(640,866)
Net decrease in Due from Veterans Debenture Revenue Fund	(11,376)	(9,785)
Net cash used by noncapital financing activities	<u>(59,560)</u>	<u>(134,738)</u>
<b>DECREASE IN CASH IN STATE TREASURY</b>	-	(6,553)
<b>CASH IN STATE TREASURY</b>		
Beginning of year	-	6,553
End of year	<u>\$ -</u>	<u>\$ -</u>

See notes to financial statements

# VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

## NOTES TO FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2000 AND 1999

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### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Organization and Description** - The California Department of Veterans Affairs (the Department) is a separate legal entity and a Cabinet level agency of the State of California. A seven-member California Veterans Board (the Board) has policy oversight of the operations of the Department. The Board's membership consists of the Department Secretary and six members, all of whom are appointed by the Governor, subject to confirmation by the State Senate. The Veterans Farm and Home Building Fund of 1943 (the Fund) was established under the authority of the California Constitution to provide low-interest, long-term farm and home mortgage loan contracts to veterans living in California. The contract loan program has been continuous since 1922. Proceeds from the sale of general obligation bonds, periodically authorized by the vote of the people of California, and revenue bonds authorized by the Legislature are used for contract loans to veterans. Expenditures are primarily for debt service and administration of the program. The Fund is tax exempt.

The financial statements represent only the activities of the Veterans Farm and Home Building Fund of 1943, and are not intended to present the financial position of the Department of Veterans Affairs of the State of California and the results of its operations and cash flows of its proprietary fund types. The financial statements of the Fund are included in the financial statements of the State of California as the State represents the primary government and has ultimate oversight responsibility for the Fund.

**Use of Estimates in the Preparation of Financial Statements** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Basis of Accounting** - The Fund has been classified as a governmental proprietary fund type for accounting purposes. Generally, revenues are recorded when earned and expenses are recognized as incurred.

Governmental Accounting Standards Board Statement No. 20 (GASB No. 20), *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Funds Accounting*, established standards for accounting and financial reporting for proprietary funds. In accordance with GASB No. 20, the Fund's proprietary fund accounting and financial reporting practices are based on all applicable GASB pronouncements as well as the following pronouncements issued on, or before, November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs) of the Committee on Accounting Procedures.

**Investments** - The Department reports all investments at fair value except for certain nonparticipating fixed interest investment contracts which are valued using cost based measures. The fair value of

investments is based on published market prices and quotations from major investment brokers and from the State of California's Surplus Money Investment Fund. Uncommitted bond proceeds restricted for loans to veterans are reflected in the balance sheet as restricted cash and investments.

***Receivables Under Contracts of Sale*** - Receivables under contracts of sale consist of the remaining contract principal balance net of the reserve for uncollectible accounts.

***Allowance for Uncollectible Contracts*** - The allowance for uncollectible contracts is established through a provision charged to operations. The allowance is an amount that management believes will be adequate to absorb losses inherent in existing contracts and commitments to extend credit, based on evaluations of the collectibility and prior loss experience of contracts and commitments to extend credit. The evaluations take into consideration such factors as changes in the nature and volume of the portfolio, overall portfolio quality, specific problem contracts, commitments, and current and anticipated economic conditions that may affect the borrowers' ability to repay the obligation.

***Contract Guarantees and Primary Mortgage Insurance*** - During 1998, the Department started collecting a contract guarantee fee on all contracts with down payments less than 20%. Such contracts are classified as high loan to value (HLTV) contracts. For eligible borrowers, the fee is used to purchase contract guarantees from the U.S. Department of Veterans Affairs (USDVA) or primary mortgage insurance. For certain HLTV contracts not eligible for USDVA guarantees, the Fund purchases primary mortgage insurance (PMI) from Radian Guaranty Inc., formerly, the Commonwealth Mortgage Assurance Company. The PMI provides lifetime coverage on the HLTV contracts, not covered by USDVA guarantees, subject to an aggregate 2% deductible. The Department is responsible for any losses not covered by the USDVA guarantees or the PMI.

***Other Real Estate Owned*** - Real estate acquired by repossession is carried at the lower of the contract balance or its net realizable value. After repossession, the value of the underlying contract is written down to the estimated fair value of the real estate, if necessary. Any subsequent write-downs are charged against operating expenses. Operating expenses of such properties, net of any related income, are included in other expenses.

***Insurance Claims Payable and Loss Reserves*** - Insurance claims payable and loss reserves include unpaid claims, incurred but not reported claims and loss reserves for the fire and hazard insurance plan and the remaining benefits payable under the Department's former self-insured life and disability protection plan.

***Fire and Hazard Insurance*** - This insurance program is provided to eligible contract holders as part of the loan program. The difference between premiums charged to contract holders and claims and expenses incurred and the change in loss reserves is included as a net amount in the statement of revenues, expenses and changes in retained earnings.

***Self-Insured Life and Disability Protection Plan*** - Beginning in 1984, the Department operated a self-funded protection plan whereby life and disability insurance was provided to eligible contract holders. This plan was terminated June 1, 1996. The life and disability benefits previously available to these members under the self-insured protection plan continue to be available to those contract holders who were receiving benefits at the time the plan was terminated. Loss reserves to satisfy these obligations of the protection plan which include future disability and life benefits were derived from an actuarial evaluation performed in 1997. Significant actuarial assumptions and methodologies used to calculate the reserve are interest, mortality, disability, prepayment, and a long-term discount rate of 7%.

***Amortization of Bond Premiums, Discounts and Issuance Costs*** - Premiums and discounts arising from the issuance of bonds and expenses incurred in connection with the issuance of bonds are capitalized and amortized using the monthly amortization method, which approximates the interest method

***New Accounting Pronouncements*** – In June 1999, the Governmental Accounting Standards Board issued Statement of Governmental Accounting Standards (“SGAS”) No 34, *Basic Financial Statements and Management’s Discussion and Analysis for State and Local Governments*. The statement establishes financial reporting standards for certain governmental entities which will require expanded financial information, management discussion and analysis and required supplemental information in their financial reporting. This statement will be effective for the Department for the year ended June 30, 2002. The Department has not determined what effect adopting SGAS No 34 will have on the Fund’s financial statements.

***Reclassification*** - Certain 1999 amounts have been reclassified to conform with the 2000 presentation

## **2. CASH AND INVESTMENTS**

The cash overdrafts of \$17,340,335 and \$6,393,464 as of June 30, 2000 and 1999 represent a liability due to the State Treasury. Cash in the State Treasury represents amounts held in the Fund's general operating accounts with the State Treasury. These monies are pooled with the monies of other State agencies and invested by the State Treasurer's office. These assets are not individually identifiable.

Investment of bond funds is restricted by applicable California law and the various bond resolutions associated with each issuance, generally, to certain types of investments, including direct obligations of the U S Government and its agencies, the State of California’s Surplus Money Investment Fund, and investment agreements with financial institutions or insurance companies rated within the top two ratings of a nationally recognized rating service. The investments with the insurance administrator, held as a deposit in accordance with a master agreement for the remaining active life and disability insurance program for disabled contract holders, is authorized by California law.

The Fund’s investments in investment agreements totaling \$562,379,567 as of June 30, 2000 are carried at cost. The interest rates on investment agreements are fixed and range from 4.98% to 7.055%. The investment agreements expire from 2000 to 2032.

All of the Fund’s investments in U S Treasury notes and bonds, corporate bonds, and the amounts administered by the insurance company are categorized as risk category 1, which is defined by GASB Statement No 3 as investments that are insured or registered or for which the securities are held by the Fund or its agent in the Fund’s name. In accordance with GASB Statement No 3, the Fund’s investments held in the State of California’s Surplus Money Investment Fund, the investment agreements and the mutual fund are not categorized as to risk.

The Fund's investments at June 30, 2000 and 1999 are as follows (in thousands)

	2000	1999
<b>Category 1</b>		
U S Treasury notes and bonds	\$ 112,107	\$ 183,645
Amounts held in trust fund with insurance administrators		
U S Treasury notes	5,433	15,627
Corporate bonds	7,441	9,596
Other:	10,452	4,371
<b>Investments Not Subject to Categorization</b>		
State of California's Surplus Money Investment Fund	226,076	239,979
Investment agreements (at cost)	562,380	890,692
Amounts held in trust fund with insurance administrators		
Mutual fund	<u>1,534</u>	<u>2,829</u>
	<u><u>\$ 925,423</u></u>	<u><u>\$ 1,346,739</u></u>

### 3. RECEIVABLES UNDER CONTRACTS OF SALE

The Fund retains title to all real property subject to contracts of sale until the contract is satisfied. The veteran's contracts have original terms of 25-30 years and bear interest at rates of 4.4% to 11.0%, depending on the age and type of contract and the classification of the current contract holder. During 1998, the Department lowered the rate on most of the existing contracts of purchase from 8.0% to 6.95%.

### 4. BONDS PAYABLE

At June 30, 2000 and 1999, bonds payable included the following (in thousands)

	2000	1999
General obligation bonds of the State of California, annual interest rates from 3.6% to 11.0% due in varying annual installments through 2032 (subject to varying redemption provisions)	\$2,528,330	\$2,687,390
Home purchase revenue bonds, annual interest rates from 3.65% to 6.15%, due in varying annual installments through 2028 (subject to varying redemption provisions)	<u>505,815</u>	<u>404,215</u>
	3,034,145	3,091,605
Discounts	(4,048)	(4,276)
Unamortized bond origination costs	(13,417)	(12,370)
Unamortized bond redemption premiums	<u>(7,569)</u>	<u>(8,572)</u>
Total	<u><u>\$3,009,111</u></u>	<u><u>\$3,066,387</u></u>

Future scheduled bond maturities at June 30, 2000 are as follows (in thousands)

2001	\$ 84,740
2002	82,350
2003	83,320
2004	131,840
2005	143,325
Thereafter	<u>2,508,570</u>
	<u>\$3,034,145</u>

General obligation bonds of the State of California are payable in accordance with the various veterans bond acts by the State General Fund. The full faith and credit of the State of California is pledged for the payment of both principal and interest. All general obligation bonds have an equal claim against the General Fund of the State of California. These bonds are included as obligations of the Fund when the proceeds from bond sales are received. The repayment for the bonds is the responsibility of the Fund. Authorized and unissued bonds under the Veterans Bond Acts of 1990 and 1996 at June 30, 2000 and 1999 were \$176,835,000.

Home Purchase Revenue bonds are special obligations of the Department payable solely from, and by a pledge of, an undivided interest in the assets of the Veterans Farm and Home Building Fund of 1943 and the Veterans Debenture Revenue Fund, a separate fund of the Department. The undivided interest in the net revenues of the 1943 Fund is secondary and subordinate to any interest or right in the 1943 Fund of the people of the State of California and of the holders of general obligation veterans bonds. At any point in time, authorized and unissued revenue bonds equal the \$1.5 billion ceiling authorized in 1987 less revenue bonds outstanding at that time. At June 30, 2000 and 1999, authorized and unissued revenue bonds were \$994,185,000 and \$1,095,785,000, respectively.

During fiscal year 1998, the Department amended the revenue bond resolution provisions regarding the Bond Reserve Account in the Veterans Debenture Revenue Fund (a separate entity). The revenue bond resolution requires the establishment and maintenance of a Bond Reserve Account in an amount equal to at least three percent of the aggregate outstanding principal amount of all Revenue Bonds with interest rates fixed to maturity. To calculate the reserve requirement, the Ninth Supplemental Resolution established, with respect to the revenue bonds with interest rates fixed to maturity issued pursuant to such resolution (1997 Series A, B and C Bonds, 1998 Series A Bonds, 1999 Series A and B Bonds, 2000 Series A, B and C Bonds), a requirement equal to at least seven percent of the outstanding principal amount of such Revenue Bonds. Amounts in the Bond Reserve Account shall be used solely for the purposes of paying the principal of and the interest on the Revenue Bonds and for making Mandatory Sinking Fund Account Payments on Revenue Bonds. Amounts on deposit in the Bond Reserve Account as of any date, in excess of the bond reserve requirement, may be transferred out of the Veterans Debenture Revenue Fund to the Fund, at the request of the Department. Investment earnings of the Veterans Debenture Revenue Fund are transferred to the Fund. At June 30, 2000 and 1999 the total assets of the Veterans Debenture Revenue Fund are shown as a receivable of the Fund. Complete financial statements of the Veterans Debenture Revenue Fund, Department of Veterans Affairs, State of California can be obtained by contacting the California Department of Veterans Affairs.

## 5. BOND REFUNDING

During fiscal year 2000, the Department issued General Obligation bonds totaling \$126,500,000 and Home Purchase Revenue bonds totaling \$117,200,000 with an average interest rate of 5.77%. Bond proceeds from the General Obligation bond issues and proceeds from the Home Purchase Revenue bond issues were used to refund previously issued General Obligation bonds of \$243,700,000.

For those bonds that could not be called for immediate redemption, approximately \$17,295,000 is deposited in an escrow account held by the State Treasurer, as escrow trustee, to provide for all future debt service payments on the defeased bonds. As a result, these bonds are considered to be defeased and the liability for those bonds is not included in the Fund's balance sheet.

During the 2000 fiscal year, the escrow trustee retired approximately \$6,015,000 of bonds which were considered defeased as of June 30, 1999.

## 6. FIRE AND HAZARD INSURANCE

Fire and hazard insurance coverage is provided on behalf of contract holders for substantially all properties subject to contracts of sale. The program is funded by amounts charged to contract holders which are considered appropriate to cover losses incurred, premiums paid for excess insurance coverage and administration fees. From the amounts charged to contract holders, the Department pays losses up to \$1,500,000 per occurrence or \$12,000,000 per policy year. Coverage in excess of the above amounts is provided under a master policy with an insurance carrier which also administers the program. The loss reserve is based on the third party administrators estimate of incurred but not reported claims based on the historical trends and loss experience within the portfolio.

The excess of premiums charged to contract holders over claims, expenses and change in loss reserves for the year ended June 30, 2000 and 1999 was as follows (in thousands):

	2000	1999
Amounts charged to contract holders	\$ 8,768	\$ 8,820
(Less) plus		
(Increase) decrease in estimated loss reserve	115	(370)
Claims loss expense	(6,475)	(6,213)
Master policy premium	(469)	(478)
Administrative fees	<u>(531)</u>	<u>(649)</u>
Excess of amounts charged to contract holders over claims and expenses and changes in reserves	<u>\$ 1,408</u>	<u>\$ 1,110</u>

## 7. SELF-INSURED LIFE AND DISABILITY PROTECTION PLAN

The Department was responsible for a self-insured life and disability protection plan for all contract holders until June 1, 1996. At that time, except for contract holders receiving benefits, the self-insured life and disability protection plan was replaced by an interim life and disability insurance plan provided by a commercial insurer, Pacific Mutual Group (PMG). Effective February 1, 1998, PMG was selected to provide a replacement, long-term life and disability plan.

As of June 30, 2000, the Department remains self-insured for approximately 903 remaining contract holders. Under the provisions of the self-insured plan benefits continue until the beneficiary returns to

active employment, dies or their contract is paid off. Loss reserves for these obligations have been actuarially determined. A portion of the required loss reserves are maintained under a third party administrator (TPA) agreement and are shown in the financial statements as investments with insurance administrators. During the year, the TPA reserves have been used to satisfy benefits payable under the self-insured protection plan. Earnings on investments held by the TPA were \$1,386,635 and \$2,836,005 in 2000 and 1999, respectively, and are included in interest revenues - investments and other in the financial statements.

The excess of claims expenses, changes in loss reserves, and administrative expenses over plan revenues whose coverages continue as obligations of the self-funded life and disability protection plan for the years ended June 30, 2000 and 1999 was as follows (in thousands):

	2000	1999
Claims expenses		
Life insurance program	\$ (2,220)	\$ (941)
Disability insurance program	<u>(10,456)</u>	<u>(10,102)</u>
Total claims expenses	(12,676)	(11,043)
Decrease in estimated loss reserves	<u>8,109</u>	<u>13,267</u>
Net claims expenses and change in loss reserves	(4,567)	2,224
Plus plan revenues		
Life insurance program	94	124
Disability insurance program	<u>134</u>	<u>158</u>
Total	228	282
Less administrative fees	<u>(422)</u>	<u>(549)</u>
Excess (deficiency) of plan revenues over net claims expense	<u>\$ (4,761)</u>	<u>\$ 1,957</u>

## 8. COMMITMENTS AND CONTINGENCIES

As of June 30, 2000 and 1999, the Fund had loan commitments to veterans for the purchase of properties under contracts of sale of approximately \$369,507,830 and \$18,313,948, respectively.

The Department is a defendant in certain litigation related to the Department's former Self-Insured Life and Disability Protection Plan, and other matters. The Department, based on the advice of its counsel, believes that the suits are without merit and intends to vigorously defend its position. Management is of the opinion that the potential liability will not have a material adverse effect on the financial statements.



The Fund leases several buildings used as district offices. Rent expense for the years ended June 30, 2000 and 1999 was \$445,083 and \$435,865, respectively. Lease terms generally range from five to ten years with options to renew for additional periods. As of June 30, 2000, minimum annual rentals under operating leases are as follows (in thousands):

2001	\$ 270
2002	152
2003	135
2004	<u>68</u>
	<u>\$ 625</u>

## 9. RETIREMENT PLAN

The Fund, through the Department and the State of California, contributes to the California Public Employees Retirement System (CalPERS), which includes an agent multiple-employer public employee retirement system and a cost sharing multiple-employee plan that acts as a common investment and administrative agent for participating entities within the State of California. Substantially all full-time employees of the Department, whose compensation is paid from the Fund, are members of CalPERS. The Plan provides a monthly allowance based on age, years of credited service, and highest average compensation over an established period of time of one to three years. Vesting occurs after five to ten years. The Plan also provides death and disability benefits. The benefits are established by contract with CalPERS in accordance with the provisions of the Public Employees Retirement Law. CalPERS issues a publicly available Comprehensive Annual Financial Report (CAFR) that includes financial statements and required supplementary information for CalPERS. A copy of that report may be obtained by writing to CalPERS, Central Supply, P O Box 1802, Sacramento, CA 95812-1802.

Contributions to the Plan are funded by both the Department and the employee, and are actuarially determined by CalPERS based on covered compensation. State employees, with the exception of employees in the second-tier plan, are required to contribute to the fund. The contribution rates of active plan members are based on a percentage of salary over a monthly base compensation amount of \$238 to \$863. With the exception of employees in the second-tier plan, state employees' required contributions vary from 5% to 8% of their salary over their base compensation amount.

Contributions by the Department to the Plan for the years ended June 30, 2000 and 1999 were approximately \$98,000 and \$625,000, or approximately 0.8% and 5.6% of participants' salaries, respectively. Employee contributions to the Plan for the years ended June 30, 2000 and 1999 were approximately \$378,000 and \$457,000 or approximately 3.1% and 4.1% of participants' salaries, respectively.

For fiscal years ended June 30, 2000 and 1999, the Department's annual pension cost was equal to the Department's required and actual contributions. The required contribution was determined as part of the June 30, 1997 actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 8.25% investment rate of return, and (b) projected salary increases that vary by duration of service. Both (a) and (b) included an inflation component of 3.5%. The actuarial value of the Department's assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a five-year period. The unfunded actuarial accrued liability is

being amortized as a level percentage of projected payroll on a closed basis. The remaining amortization period at June 30, 1997 was 32 years. Three-year fund trend information is as follows:

Three-Year Fund Trend Information			
Fiscal Year End	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
June 30, 1998	\$ 956,000	100 %	\$ -
June 30, 1999	\$ 625,000	100 %	\$ -
June 30, 2000	\$ 98,000	100 %	\$ -

The most recent actuarial valuation of CalPERS indicated that there was an unfunded liability for vested benefits due current employee participants in the plan. The amount of the unfunded liability applicable to each agency or department cannot be determined. Trend information, which presents CalPERS progress in accumulating sufficient assets to pay benefits when due is presented in the June 30, 1998 CalPERS CAFR.

Since all state agencies and departments are considered by CalPERS collectively as a single employer, the actuarial value of plan assets, the actuarial accrued liability, the total unfunded liability, the actuarial value of assets as a percentage of the actuarial accrued liability, and the ratio of unfunded actuarial liability to annual covered payroll attributable to the Department's employees, whose compensation is paid from the Fund, cannot be determined.

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## EXHIBIT 2

### CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA

#### Contracts of Purchase

Set forth below is certain financial information regarding Contracts of Purchase.

#### *Existing Contracts of Purchase*

The following charts describe the current loan to value ratios and geographic distribution of Contracts of Purchase financed under the Program as of April 30, 2001 using proceeds of Veterans G.O. Bonds, Revenue Bonds and other amounts under the 1943 Fund.

#### Current Loan-to-Value Ratio of Contracts of Purchase<sup>(1)(2)</sup>

	<u>Uninsured</u>	<u>Radian Insured<sup>(5)</sup></u>	<u>Radian Insured<sup>(6)</sup></u>	<u>VA Guaranteed</u>	<u>Total</u>
<b>Single Family Homes</b>					
Less than 30% LTV	\$ 112,724	\$ 106	\$ 36	\$ 106	\$ 112,972
30-49% LTV .....	257,741	697	74	374	258,886
50-59% LTV .....	174,524	889	--	168	175,581
60-69% LTV .....	212,283	4,940	68	559	217,850
70-79% LTV .....	239,827	71,666	--	3,290	314,783
Sub-total .....	<u>\$ 997,099</u>	<u>\$ 78,298</u>	<u>\$ 178</u>	<u>\$ 4,497</u>	<u>\$ 1,080,072</u>
80-84% LTV .....	\$ 21,930	\$ 150,321	\$ 14,461	\$ 6,646	\$ 193,358
85-89% LTV .....	28,273	271,568	54,245	26,217	380,303
90-94% LTV .....	42,504	129,846	107,204	76,815	356,369
95-97% LTV .....	40,153	1,653	139,818	63,471	245,095
Sub-total .....	<u>\$ 132,860</u>	<u>\$ 553,388</u>	<u>\$ 315,728</u>	<u>\$ 173,149</u>	<u>\$ 1,175,125</u>
Greater than 97% LTV	\$ 34,901	\$ 1,516	\$ 137,987	\$ 185,906	\$ 360,310
<b>Other Property Types</b>					
Farms .....	\$ 5,494	\$ 200	--	--	\$ 5,694
Mobile Homes in Parks .....	8,709	--	54	--	8,763
Sub-total .....	<u>\$ 14,203</u>	<u>\$ 200</u>	<u>\$ 54</u>	<u>--</u>	<u>\$ 14,457</u>
<b>Special Status</b>					
<b>Contracts of Purchase</b>					
Real Estate Owned <sup>(3)</sup> .....	\$ 13,147	\$ 5,187	\$ 1,079	\$ 274	\$ 19,687
Disability Program <sup>(4)</sup> .....	27,433	--	1,749	--	29,182
Sub-total .....	<u>\$ 40,580</u>	<u>\$ 5,187</u>	<u>\$ 2,828</u>	<u>\$ 274</u>	<u>\$ 48,869</u>
Total Portfolio .....	<u>\$ 1,219,643</u>	<u>\$ 638,589</u>	<u>\$ 456,775</u>	<u>\$ 363,826</u>	<u>\$ 2,678,833</u>

(1) 000's omitted

(2) LTV based on current Contracts of Purchase balance divided by original appraised value of the property, except that the Department updates the appraised value of the home when the veteran applies for a home improvement loan. In such cases, the LTV is calculated with the new appraised value.

(3) Repossessed properties and delinquent Contracts of Purchase carried as REO on financial statements.

(4) Contracts of Purchase where payments are made on behalf of veterans by the Department's life and disability coverage plan.

(5) The policy was executed on February 28, 1998.

(6) The policy was executed on July 1, 2000.

### Geographic Distribution of Contracts of Purchase

<u>County</u>	<u>Approximate Current Contract Balance</u>
San Diego .....	\$ 301,747,371
Sacramento .....	279,300,632
Los Angeles .....	192,802,465
San Bernardino .....	174,244,044
Riverside .....	165,811,279
Orange .....	121,671,952
Fresno .....	118,810,322
Kern .....	106,281,256
Solano .....	101,249,962
Placer .....	92,946,378
San Joaquin .....	80,068,502
Shasta .....	65,773,880
Contra Costa .....	65,584,827
Other Northern California Counties .....	424,868,050
Other Central California Counties .....	283,363,645
Other Southern California Counties .....	104,308,027
Statewide--California .....	<u>\$ 2,678,832,592</u>

### Contracts of Purchase Origination and Principal Repayment Experience

The following tables represent, respectively, a historical picture of Contract of Purchase originations since the 1985-86 fiscal year and selected principal repayments with respect to Contracts of Purchase since the 1985-1986 fiscal year.

#### New Contracts of Purchase During the Fiscal Year<sup>(1)</sup>

<u>Fiscal Year Ending June 30</u>	<u>Veterans G.O. Bonds</u>		<u>Unrestricted Funds</u>		<u>Revenue Bonds</u>		<u>Total</u>	
	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>
1985 .....	4,196	\$ 290,885,900			2,301	\$ 154,244,600	6,497	\$ 445,130,500
1986 .....	3,484	243,955,800			2,401	160,782,200	5,885	404,738,000
1987 .....	1,569	108,789,700			1,160	75,836,800	2,729	184,626,500
1988 .....	2,958	236,054,500			1,397	99,040,900	4,355	335,095,400
1989 .....	3,112	252,796,300			1,154	83,076,100	4,266	335,872,400
1990 .....	2,097	187,445,600			522	38,150,800	2,619	225,596,400
1991 .....	1,927	200,393,500			359	29,189,600	2,286	229,583,100
1992 .....	1,086	111,600,500			388	34,671,600	1,474	146,272,100
1993 .....	740	94,417,100			286	27,443,800	1,026	121,860,900
1994 .....	843	117,213,779			337	34,740,536	1,180	151,954,315
1995 .....	2,109	286,178,376			822	84,860,894	2,931	371,039,270
1996 .....	762	107,751,444			222	22,723,617	984	130,475,061
1997 .....	766	118,344,636			201	21,853,933	967	140,198,569
1998 .....	615	99,224,002	188	\$ 17,716,376	164	18,871,066	967	135,811,444
1999 .....	758	129,521,359	575	92,728,280	274	33,284,343	1,607	255,533,982
2000 .....	1,045	185,180,534	1,725	333,328,690	708	92,214,409	3,478	610,723,633
2001 <sup>(2)</sup> .....	782	124,625,136	1,178	227,654,156	654	96,616,786	2,614	448,896,078

(1) Number of new Contracts of Purchase does not include home improvement loans.

(2) 10-month period through April 30, 2001.

**Selected Principal Flows with respect to Contracts of Purchase  
Funded by both Veterans G.O. Bonds and Revenue Bonds**

Fiscal Year Ending June 30	Principal Flows				Rates			
	Contracts Funded During Year (000s)	Contract Prepayments During Year (000s)	Other Principal Receipts-Losses During Year (000s)	Contract Balance at End of Year (000s)	Average Rate on all Outstanding Contracts	Average of Monthly FHLMC 30-year Conventional Loan Rate	Annual Average Prepayment Rate	Annual Average Origination Rate
1985	\$ 445,131	\$ 123,669	\$ 88,308	\$ 3,142,526	8.0%	13.8%	4.1%	14.7%
1986	404,738	179,809	94,970	3,272,485	8.0	11.5	5.6	12.6
1987	184,627	261,675	99,569	3,095,868	7.7	9.8	8.2	5.8
1988	335,095	198,396	114,178	3,118,389	7.0	10.5	6.4	10.8
1989	335,872	207,471	105,896	3,140,894	7.3	10.6	6.6	10.7
1990	225,596	232,085	96,639	3,037,766	8.0	10.1	7.5	7.3
1991	229,583	191,895	92,722	2,982,732	8.0	9.9	6.4	7.6
1992	146,272	246,150	92,975	2,789,879	8.0	9.0	8.5	5.1
1993	121,861	273,817	105,629	2,532,294	8.0	8.0	10.3	4.6
1994	151,954	359,749	98,773	2,225,726	8.0	7.3	15.1	6.4
1995	371,039	111,984	74,706	2,410,075	7.8	8.7	4.8	16.0
1996	130,475	141,767	92,521	2,306,262	8.0	7.5	6.0	5.5
1997	140,199	111,254	106,027	2,229,180	8.0	7.9	4.9	6.2
1998	135,811	172,134	94,106	2,098,752	7.7	7.2	8.0	6.3
1999	255,534	183,776	103,620	2,066,889	6.9	6.9	8.8	12.3
2000	610,724	138,401	101,533	2,437,679	6.8	8.1	6.1	27.1
2001 <sup>(1)</sup>	448,896	142,291	65,451	2,678,833	6.8	7.5	6.7	21.1
	<u>\$ 4,673,407</u>	<u>\$ 3,276,323</u>	<u>\$ 1,627,623</u>					

**Reservation rates on new Contracts of Purchase for period:**

Period	Veterans G.O. Bonds*	Unrestricted Funds*	Revenue Bonds*
Prior to January 1, 1999, substantially all newly originated Contracts have the same rate as the then outstanding Contracts.			
January 1, 1999 thru June 30, 2000	6.65%	6.65%	5.95%
July 1, 2000 thru February 28, 2001	7.50%	7.95%	6.95%
March 1, 2001 thru May 31, 2001	6.50%	7.95%	6.40%
June 1, 2001 thru present	6.50%	7.10%	6.40%

\* Rates for contracts of purchase for mobile home in parks shall be 1% higher than the applicable established rates.

(1) 10-month period through April 30, 2001.

## Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments

The following table shows amounts expected to become available to fund Contracts of Purchase following the expected issuance of the Offered Veterans G.O. Bonds. The universe of veterans eligible to receive Contracts of Purchase financed by the different classifications of available moneys is described in Appendix B under "THE PROGRAM--Qualifying Veteran Status." Additional moneys may become available to finance Contracts of Purchase through the future issuances of Veterans G.O. Bonds and Revenue Bonds. The Department has full discretion to use moneys available from prior, current or future bond issues in any order of priority it chooses. As of April 30, 2001, the Department had 235 pending applications for Contracts of Purchase in the aggregate amount of approximately \$36,000,000.

Bond Series	Deposit as of	Balance as of	Respective Series Bond Proceeds Subaccounts			Investment	Investment Rate (%)
			Unrestricted Moneys <sup>(1)</sup>	Qualified Veterans Mortgage Bond Proceeds <sup>(1)</sup>	Qualified Mortgage Bond Proceeds <sup>(1)</sup>		
Veterans G.O. Bond Proceeds Subaccounts							
Series BP.....		4/30/01	-0-	\$ 2,887	-0-	SMIF <sup>(3)</sup>	Variable
Series BJ 11/12 .....		4/30/01	-0-	100,006	-0-	AIG <sup>(8)</sup>	6.481
Series BT/BU .....		4/30/01	-0-	11,941	-0-	SMIF <sup>(3)</sup>	Variable
Series BV/BW.....		4/30/01	-0-	28,630	-0-	SMIF <sup>(3)</sup>	Variable
Series BV/BW.....	6/01/01		-0-	56,500	-0-	SMIF <sup>(3)</sup>	Variable
Series BX <sup>(12)</sup> .....	6/20/01		-0-	6,243	-0-	SMIF <sup>(3)</sup>	Variable
Sub-total.....			-0-	\$ 206,207	-0-		
Veterans G.O. Bond Recycling Subaccounts							
Series BM/BN .....		4/30/01	\$ 9,262	-0-	-0-	WestLB <sup>(5)(11)</sup>	5.380
Unrestricted.....		4/30/01	35,604	-0-	-0-	SMIF <sup>(3)</sup>	Variable
Sub-total.....			\$ 44,866	-0-	-0-		
Total Veterans G.O. Bonds ....			\$ 44,866	\$ 206,207	-0-		
Revenue Bonds Proceeds Subaccounts							
1997 C .....		4/30/01	-0-	-0-	\$ 91,397	Trinity <sup>(10)</sup>	6.157
2001 A .....	5/3/01		\$ 4,074	-0-	-0-	SMIF <sup>(3)</sup>	Variable
Sub-total.....			\$ 4,074	-0-	\$ 91,397		
Revenue Bonds Recycling Subaccounts							
Section 143 .....		4/30/01	-0-	-0-	\$ 8,289	Soc Gen <sup>(2)(4)</sup>	5.730
1991 A Recycling .....		4/30/01	\$ 5,416	-0-	-0-	BLB <sup>(6)(11)</sup>	6.060
1999 A/B.....		4/30/01	9,814	-0-	-0-	BLB <sup>(7)(11)</sup>	5.300
2000 A/B/C.....		4/30/01	4,000	-0-	-0-	WestLB <sup>(9)(11)</sup>	6.460
1997 C .....		4/30/01	-0-	-0-	2,850	SMIF <sup>(3)</sup>	Variable
Sub-total.....			\$ 19,230	-0-	\$ 11,139		
Total Revenue Bonds .....			\$ 23,304	-0-	\$ 102,536		
Grand Total.....			\$ 68,170	\$ 206,207	\$ 102,536		

Footnotes are on the following page.

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- (1) 000's omitted.
  - (2) On August 18, 1999, Moody's confirmed the long-term rating (senior debt and deposits) of Societe Generale at Aa3 with a negative outlook.
  - (3) Surplus Money Investment Fund. Amounts invested in SMIF may be withdrawn and reinvested at any time.
  - (4) Investment agreement maturing December 1, 2001 with Societe Generale.
  - (5) Investment agreement maturing December 1, 2028 with Westdeutsche Landesbank Girozentrale.
  - (6) Investment agreement maturing December 1, 2009 with Bayerische Landesbank Girozentrale.
  - (7) Investment agreement maturing December 1, 2028 with Bayerische Landesbank Girozentrale.
  - (8) Investment agreement maturing December 1, 2002 with AIG Matched Funding Corporation ("AIG").
  - (9) Investment agreement maturing June 1, 2010 with Westdeutsche Landesbank Girozentrale.
  - (10) Investment agreement maturing December 1, 2002 with Trinity Plus Funding Company, LLC ("Trinity"). Under certain circumstances, Trinity will have the benefits of a letter of credit from General Electric Capital Corporation ("GE Capital") and of a revolving liquidity facility under which GE Capital is a lender (there can be additional lenders under the liquidity facility). However, the aggregate of the amounts available under the letter of credit and the liquidity facility may be significantly less than Trinity's obligations under its investment agreements.
  - (11) Both S&P and Moody's have announced negative rating outlooks for these banks.
  - (12) Offered Veterans G.O. Bonds.



## Cancellations and Delinquencies

Set forth in the table below is a comparative chart of delinquent, cancelled and repossessed Contracts of Purchase and certain comparative information regarding USDVA guaranteed loans during the same period.

	1994 <sup>(1)</sup>	1995 <sup>(1)</sup>	1996 <sup>(1)</sup>	1997 <sup>(1)</sup>	1998 <sup>(1)</sup>	1999 <sup>(1)</sup>	2000 <sup>(2)</sup>	2001 <sup>(3)</sup>
<b>Percentage of Number of Contracts of Purchase</b>								
<b>Delinquent</b>								
30-60 days <sup>(6)</sup> .....	--(7)	--(7)	--(7)	--(7)	--(7)	--(7)	3.27%	3.68%
60+ days <sup>(6)</sup> .....	--(7)	--(7)	--(7)	--(7)	--(7)	--(7)	2.08%	1.93%
Cancelled Contracts and Real Estate in inventory <sup>(4)</sup> .....	--(7)	--(7)	--(7)	--(7)	--(7)	--(7)	0.49%	0.67%
<b>USDVA Guaranteed Loans<sup>(5)</sup></b>								
<b>Percentages in U.S.</b>								
<b>Delinquent</b>								
30-60 days .....	4.07%	4.14%	4.59%	4.54%	4.45%	4.35%	4.19%	5.31%
60+ days .....	2.25%	2.21%	2.20%	2.21%	2.35%	2.26%	2.25%	2.81%
Foreclosures in inventory .....	1.44%	1.26%	1.54%	1.81%	1.77%	1.82%	1.44%	1.19%
<b>Percentages in California</b>								
<b>Delinquent</b>								
30-60 days .....	3.42%	4.03%	4.23%	4.30%	4.28%	4.13%	4.05%	4.85%
60+ days .....	2.36%	2.53%	2.36%	2.52%	2.61%	2.41%	2.27%	2.71%
Foreclosures in inventory .....	2.28%	2.31%	3.18%	3.54%	2.92%	2.21%	1.39%	1.01%

- (1) As of June 18 for Department's and as of June 30 for USDVA data.
- (2) As of June 30, 2000 for Department's and USDVA data.
- (3) As of April 30, 2001 for Department's and as of December 31, 2000 for USDVA data.
- (4) Bankruptcies are included in cancelled Contracts statistics and do not exceed in any period more than 10% of total cancellations and bankruptcy category. Federal bankruptcy law precludes repossession action of Contracts of Purchase when veteran is in bankruptcy proceedings until the automatic stay is lifted.
- (5) Source: National Delinquency Survey published by the Mortgage Bankers Association of America.
- (6) As of the June 30, 1999 installation of the Integrated Loan Processing and Financial Information System, the Department reports delinquencies on a basis consistent with industry standards.
- (7) The data below represents the Department's reporting method prior to the implementation of the Integrated Loan Processing and Financial Information System.

	1994 <sup>(1)</sup>	1995 <sup>(1)</sup>	1996 <sup>(1)</sup>	1997 <sup>(1)</sup>	1998 <sup>(1)</sup>	1999 <sup>(1)</sup>
<b>Percentage of Number of Contracts of Purchase</b>						
<b>Delinquent<sup>(7)</sup></b>						
40-67 days .....	0.99%	1.45%	2.90%	1.65%	0.78%	0.87%
8+ days .....	4.24%	3.12%	2.50%	3.22%	1.99%	1.34%
Cancelled Contracts and Real Estate in inventory <sup>(4)</sup> .....	0.73%	1.28%	1.89%	1.86%	1.49%	0.94%

# Veterans G.O. Bonds and Revenue Bonds

The chart below sets forth certain information regarding Veterans G.O. Bonds and Revenue Bonds, including those expected to be redeemed as a result of the issuance of the Offered Veterans G.O. Bonds.

## Selected Information with Respect to Veterans G.O. Bonds and Revenue Bonds

Series	Bonds Outstanding as of 4/1/01	Bonds Expected to be Outstanding as of 8/1/01	Final Maturity or Mandatory Tender Date of Series	Next Optional Call Date	Call Price on Such Date	Maximum Coupon Subject to Optional Call	Bonds Subject to Special Redemption <sup>(9)</sup>
Veterans G.O. Bonds Issued Prior to the Mortgage Subsidy Bond Tax Act of 1980							
BM.....	\$ 66,600,000	\$ 53,385,000	December 1, 2025	-- <sup>(1)</sup>	-- <sup>(1)</sup>	5.450%	Excess Revenues/Unexpended
BN2-4.....	91,065,000	71,250,000	December 1, 2028	-- <sup>(1)</sup>	-- <sup>(1)</sup>	5.450%	Excess Revenues/Unexpended
Sub-total .....	\$ 157,665,000	\$ 124,635,000					
Veterans G.O. Bonds Issued as Qualified Veterans Mortgage Bonds under the 1954 Code							
AH.....	\$ 42,000,000	--					
AK.....	9,000,000	9,000,000	April 1, 2007	Non-callable	N.A.	N.A.	No
AL.....	26,000,000	26,000,000	April 1, 2007	Non-callable	N.A.	N.A.	No
AM.....	46,000,000	46,000,000	October 1, 2008	Non-callable	N.A.	N.A.	No
AN/AP.....	75,000,000	75,000,000	April 1, 2009	Non-callable	N.A.	N.A.	No
AQ.....	75,000,000	75,000,000	October 1, 2008	Non-callable	N.A.	N.A.	No
AR.....	34,000,000	34,000,000	October 1, 2009	Non-callable	N.A.	N.A.	No
AS.....	38,000,000	38,000,000	October 1, 2009	Non-callable	N.A.	N.A.	No
AT.....	165,325,000	165,325,000	February 1, 2010	Non-callable	N.A.	N.A.	No
AU.....	113,120,000	113,120,000	October 1, 2010	Non-callable	N.A.	N.A.	No
AV.....	77,345,000	77,345,000	October 1, 2010	Non-callable	N.A.	N.A.	No
Sub-total .....	\$ 700,790,000	\$ 658,790,000					
Veterans G.O. Bonds Issued as Qualified Veterans Mortgage Bonds under the 1986 Code							
BC/BF <sup>(2)</sup> .....	\$ 211,245,000	\$ 211,245,000	February 1, 2027	-- <sup>(4)</sup>	100%	6.550%	Allocated Prepayments <sup>(1)</sup>
BG/BH.....	586,355,000	586,355,000	December 1, 2032	-- <sup>(5)</sup>	-- <sup>(5)</sup>	5.600% <sup>(5)</sup>	Excess Revenues/Unexpended
BJ/6.....	56,500,000	--					
BJ/7/8.....	60,000,000	60,000,000	December 1, 2032	-- <sup>(6)</sup>	-- <sup>(6)</sup>	6.200% <sup>(6)</sup>	Excess Revenues/Unexpended
BJ/9/10.....	40,000,000	40,000,000	December 1, 2032	-- <sup>(7)</sup>	-- <sup>(7)</sup>	6.050% <sup>(7)</sup>	Excess Revenues/Unexpended
BK/BL.....	255,615,000	255,615,000	December 1, 2012	-- <sup>(5)</sup>	-- <sup>(5)</sup>	5.300% <sup>(5)</sup>	Excess Revenues/Unexpended
BP/BN1.....	14,000,000	14,000,000	December 1, 2026	-- <sup>(1)</sup>	-- <sup>(1)</sup>	5.500% <sup>(1)</sup>	Excess Revenues/Unexpended
BQ/BR.....	80,000,000	80,000,000	December 1, 2029	June 1, 2004	101%	5.300%	Excess Revenues/Unexpended
BS.....	26,500,000	26,500,000	December 1, 2008	Non-callable	N/A	N/A	Excess Revenues/Unexpended
BJ11/12 <sup>(8)</sup> .....	115,000,000	115,000,000	December 1, 2032	-- <sup>(8)</sup>	-- <sup>(8)</sup>	5.700%	Excess Revenues/Unexpended
BT/BU.....	115,400,000	115,400,000	December 1, 2026	December 1, 2005	101%	5.650%	Excess Revenues
BV/BW.....	--	86,225,000	December 1, 2032	June 1, 2006	101%	5.700%	Excess Revenues/Unexpended
BX <sup>(10)</sup> .....	--	42,000,000	December 1, 2032	June 1, 2006	101%	5.500%	Excess Revenues
Sub-total .....	\$ 1,560,615,000	\$ 1,632,340,000					

Series	Bonds Outstanding as of 4/1/01	Bonds Expected to be Outstanding as of 8/1/01	Final Maturity or Mandatory Tender Date of Series	Next Optional Call Date	Call Price on Such Date	Maximum Coupon Subject to Optional Call	Bonds Subject to
							Special Redemption <sup>(a)</sup>
Revenue Bonds Issued as Qualified Mortgage Bonds under the 1986 Code							
1997 A/B .....	\$ 20,225,000	\$ 20,225,000	December 1, 2028	December 1, 2008	101%	5.500%	Excess Revenues/Unexpended
1997 C .....	97,130,000	97,130,000	December 1, 2019	January 9, 2011	101%	5.500%	Excess Revenues/Unexpended
1998 A .....	121,025,000	113,690,000	December 1, 2019	December 1, 2008	101%	5.450%	Excess Revenues/Unexpended
Sub-total .....	\$ 238,380,000	\$ 231,045,000					
Revenue Bonds Issued to Refund Bonds Issued Prior to Mortgage Subsidy Bond Tax Act of 1980							
1999 A .....	\$ 54,170,000	\$ 54,170,000	December 1, 2027	June 1, 2004	101%	5.200%	Excess Revenues/Unexpended
1999 B .....	86,085,000	86,085,000	December 1, 2028	June 1, 2004	101%	5.200%	Excess Revenues/Unexpended
2000 A .....	54,000,000	54,000,000	December 1, 2004	June 1, 2002	100%	4.750%	Excess Revenues/Unexpended
2000 B .....	63,200,000	63,200,000	December 1, 2006	June 1, 2002	100%	5.000%	Excess Revenues/Unexpended
2000 C .....	42,600,000	42,600,000	December 1, 2027	June 1, 2005	101%	6.150%	Excess Revenues/Unexpended
2001 A .....	--	39,840,000	December 1, 2028	June 1, 2006	101%	5.600%	Excess Revenues/Unexpended
Sub-total .....	\$ 300,055,000	\$ 339,895,000					
TOTAL REVENUE BONDS....	\$ 538,435,000	\$ 570,940,000					
TOTAL ALL BONDS....	\$ 2,957,505,000	\$ 2,986,705,000					

(1) The Series BM Bonds and Series BN Bonds maturing on and before December 1, 2004 are subject to optional redemption at par on and after June 1, 2000. The remaining Series BM Bonds and Series BN Bonds and all of the Series BP Bonds are subject to optional redemption on and after December 1, 2003, initially at 101% of the principal amount thereof, declining to par on and after December 1, 2004.

(2) Series BC/BF includes Series BC, Series BD, Series BE and Series BF.

(3) Subject to redemption at par from a portion of prepayments on all Contracts of Purchase as allocated to Series based on periodically determined ratio of outstanding bonds (including Veterans G.O. Bonds and Revenue Bonds) of Series to all outstanding bonds. Series BC/BF is now subject to optional redemption at par.

(4) The Series BC/BF Bonds are subject to optional redemption prior to their respective stated maturity dates, in whole on the first day of any month, or in part on any interest payment date.

(5) Except as described in the next sentence, the Series BG Bonds, Series BH Bonds, and Series BL Bonds are subject to optional redemption on and after December 1, 2008, initially at 101% of the principal amount thereof, declining to par on December 1, 2009. The Series BH Bonds maturing on December 1, 2018, December 1, 2024, and December 1, 2032 are subject to optional redemption on and after December 1, 2003 at 102% of the principal amount thereof, declining to 101% of the principal amount thereof on and after December 1, 2004, and declining further to par on December 1, 2005. The Series BK Bonds are not subject to optional redemption.

(6) The BJ-7/8 Serial Bonds maturing on December 1, 2010 through and including December 1, 2016 are subject to optional redemption on December 1, 2009, initially at

101% of the principal amount thereof, declining to par on and after December 1, 2010. The BJ-7/8 Term Bonds maturing on December 1, 2018, December 1, 2024 and December 1, 2032 are subject to optional redemption on December 1, 2005, initially at 102% of the principal amount thereof, declining to par on and after December 1, 2007.

- (7) The BJ-9/10 Serial Bonds maturing on December 1, 2010 through and including December 1, 2016 are subject to optional redemption on April 27, 2010, initially at 101% of the principal amount thereof, declining to par on and after April 27, 2011. The BJ-9/10 Term Bonds maturing on December 1, 2018, December 1, 2024 and December 1, 2032 are subject to optional redemption on April 27, 2006, initially at 102% of the principal amount thereof, declining to par on and after April 27, 2008.
- (8) The BJ-11/12 Serial Bonds maturing on December 1, 2011 through and including December 1, 2016 are subject to optional redemption on December 19, 2010, initially at 101% of the principal amount thereof, declining to par on and after December 19, 2011. The BJ-11/12 Term Bonds maturing on December 1, 2018, December 1, 2024 and December 1, 2032 are subject to optional redemption on December 19, 2006, initially at 102% of the principal amount thereof, declining to par on and after December 19, 2008.

- (9) Excess Revenues includes principal prepayments.

- (10) Offered Veterans G.O. Bonds.

### Additional Investments

In addition to the investments described above under "Contracts of Purchase--Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments," the following investments have been made or will be made with respect to moneys in the 1943 Fund and in the Bond Reserve Account which secures the Revenue Bonds:

<u>Bond Series</u>	<u>Account Designation<sup>(1)</sup></u>	<u>Amount (000s)</u>	<u>Investment Provider<sup>(1)</sup></u>	<u>Initial Investment Date</u>	<u>Investment Maturity Date</u>	<u>Interest Rate (%)</u>	<u>Bond Series</u>	<u>Account Designation<sup>(1)</sup></u>	<u>Amount (000s)</u>	<u>Investment Provider<sup>(1)</sup></u>	<u>Initial Investment Date</u>	<u>Investment Maturity Date</u>	<u>Interest Rate (%)</u>
1997/1998	Reserve	\$5,251	Societe Generale <sup>(1)</sup>	3/26/98	12/1/28	5.75	BJ 7/8	Revenue/ Recycling	variable <sup>(8)</sup>	Bayerische Landesbank Girozentrale <sup>(9)</sup>	12/1/99	12/1/32 <sup>(8)</sup>	6.06
1997/1998	Reserve	\$7,001 <sup>(2)</sup>	U.S. Treasury	5/8/98	5/15/05	6.50	1991 A	Revenue/ Recycling	variable <sup>(8)</sup>	Bayerische Landesbank Girozentrale <sup>(9)</sup>	12/1/99	12/1/32 <sup>(8)</sup>	6.06
1999 A/B	Reserve	\$9,817	Westdeutsche Landesbank Girozentrale <sup>(9)</sup>	3/30/99	12/1/28	5.38	2000 A/B	Revenue/ Recycling	variable <sup>(10)</sup>	Westdeutsche Landesbank Girozentrale <sup>(9)</sup>	3/29/00	12/1/27 <sup>(10)</sup>	6.46
2000 A/B/C	Reserve	\$10,186	Trinity Plus Funding Company, LLC	4/1/00	12/1/27	6.895	BJ 9/10	Revenue/ Recycling	variable <sup>(11)</sup>	Westdeutsche Landesbank Girozentrale <sup>(9)</sup>	4/27/00	12/1/32 <sup>(11)</sup>	6.46
1997 C	Reserve	\$5,733	Westdeutsche Landesbank Girozentrale <sup>(9)</sup>	1/1/01	12/1/19	5.625	BS	Revenue	variable <sup>(11)</sup>	Westdeutsche Landesbank Girozentrale <sup>(9)</sup>	4/27/00	12/1/32 <sup>(11)</sup>	6.46
2001 A	Reserve	\$2,789	SMIF <sup>(16)</sup>	5/3/01	-- <sup>(16)</sup>	Variable	BJ 11/12	Revenue/ Recycling	variable <sup>(12)</sup>	Westdeutsche Landesbank Girozentrale <sup>(9)</sup>	12/19/00	12/1/32 <sup>(12)</sup>	5.50
BG/BH/BK /BL	Revenue/ Recycling	variable <sup>(4)</sup>	Societe Generale <sup>(3)</sup>	12/29/97	12/1/32	5.91	BT/BU	Revenue/ Recycling	variable <sup>(13)</sup>	Westdeutsche Landesbank Girozentrale <sup>(9)</sup>	12/19/00	12/1/26 <sup>(13)</sup>	5.50
1997/1998	Revenue/ Restricted Recoveries	variable	Societe Generale <sup>(3)</sup>	3/26/98	12/1/28	5.91	1997 C	Revenue/ Restricted Recoveries	variable <sup>(14)</sup>	Westdeutsche Landesbank Girozentrale <sup>(9)</sup>	1/9/01	12/1/19	5.50
BM/BN2-4	Revenue/ Recycling	variable <sup>(5)</sup>	Westdeutsche Landesbank Girozentrale <sup>(9)</sup>	5/5/98	12/1/28	5.38	BV/BW	Revenue/ Recycling	variable <sup>(15)</sup>	Bayerische Landesbank Girozentrale <sup>(9)</sup>	6/20/01	12/1/32 <sup>(15)</sup>	5.67
BP/BN-1	Revenue/ Recycling	variable <sup>(5)</sup>	Westdeutsche Landesbank Girozentrale <sup>(9)</sup>	5/5/98	12/1/28	5.38	2001 A	Revenue/ Recycling	variable <sup>(15)</sup>	Bayerische Landesbank Girozentrale <sup>(9)</sup>	6/20/01	12/1/32 <sup>(15)</sup>	5.67
1999 A/B	Revenue/ Recycling	variable <sup>(6)</sup>	Bayerische Landesbank Girozentrale <sup>(9)</sup>	3/30/99	12/1/28	5.30	BX	Revenue/ Recycling	variable <sup>(15)</sup>	Bayerische Landesbank Girozentrale <sup>(9)</sup>	6/20/01	12/1/32 <sup>(15)</sup>	5.67
BQ/BR	Revenue/ Recycling	variable <sup>(7)</sup>	Westdeutsche Landesbank Girozentrale <sup>(9)</sup>	4/28/99	12/1/29	5.37							

Footnotes are on the following page.

- 1) Accounts are established in the resolutions authorizing the issuance of Revenue Bonds. All investments are investment agreements unless otherwise noted.
- 2) At cost. Invested in U.S. Treasury Bonds.
  - 3) On August 18, 1999, Moody's confirmed the long-term rating (senior debt and deposits) of Societe Generale at Aa3 with a negative outlook.
  - 4) Maximum permitted amount on deposit under investment agreement at any one time is \$250,000,000.
  - 5) Maximum permitted amount on deposit under investment agreement for all (BM, BN, and BP) subaccounts is \$50,000,000.
  - 6) Maximum permitted amount on deposit under investment agreement for both subaccounts is \$75,000,000.
  - 7) Maximum permitted amount on deposit under investment agreement for both subaccounts is \$35,000,000.
  - 8) Maximum permitted amount on deposit under investment agreement for all (BJ 7/8, and 1991 A) subaccounts is \$25,000,000. Investment maturity date for the recycling subaccounts is December 1, 2009.
  - 9) Both S&P and Moody's have announced negative rating outlooks for these banks.
  - 10) Maximum permitted amount on deposit under investment agreement for both subaccounts is \$20,000,000. Investment maturity date for the recycling subaccount is June 1, 2010.
  - 11) Maximum permitted amount on deposit under investment agreement for all three (BJ 9/10, and BS) subaccounts is \$20,000,000. Investment maturity date for BJ-9/10 G.O. Bond Series Recycling Subaccount is June 1, 2010.
  - 12) Maximum permitted amount on deposit under investment agreement for both subaccounts is \$25,000,000. Investment maturity date for BJ-11/12 G.O. Bond Series Recycling Subaccount is December 1, 2010.
  - 13) Maximum permitted amount on deposit under investment agreement for both subaccounts is \$20,000,000. Investment maturity date for BT/BU G.O. Bond Series Recycling Subaccount is December 1, 2010.
  - 14) Maximum permitted amount on deposit under investment agreement for both subaccounts is \$97,130,000.
  - 15) Maximum permitted amount on deposit under investment agreement for all (BV/BW, 2001 A, BX) subaccounts is \$25,000,000. Investment maturity date for all (BV/BW, 2001 A, BX) recycling subaccounts is December 1, 2011.

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## APPENDIX C

### BOOK-ENTRY SYSTEM

The information concerning The Depository Trust Company ("DTC") and DTC's book-entry system has been obtained from sources that the State Treasurer believes to be reliable, but the Treasurer and the Underwriters take no responsibility for the accuracy or completeness thereof.

DTC, New York, New York, will act as securities depository for the Offered Veterans G.O. Bonds. The Offered Veterans G.O. Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended. DTC holds securities that its participants ("Participants") deposit with DTC. DTC also facilitates the settlement among Participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in accounts of Participants, thereby eliminating the need for physical movement of securities certificates. Direct Participants (the "Direct Participants") include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc., and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as banks, securities brokers and dealers and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). The Rules applicable to DTC and its Participants and Indirect Participants are on file with the Securities and Exchange Commission.

Purchases of the Offered Veterans G.O. Bonds under the DTC System must be made by or through Direct Participants, which will receive a credit for the Offered Veterans G.O. Bonds on DTC's records. The ownership interest of each actual purchaser of each Offered Veterans G.O. Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Offered Veterans G.O. Bonds are to be accomplished by entries made on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Offered Veterans G.O. Bonds, except in the event that use of the book-entry system for the Offered Veterans G.O. Bonds is discontinued.

To facilitate subsequent transfers, all Securities deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. (or such other name as may be requested by an authorized representative of DTC). The deposit of Offered Veterans G.O. Bonds with DTC and their registration in the name of Cede & Co. do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Offered Veterans G.O. Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Offered Veterans G.O.



Bonds are credited, which may or may not be the Beneficial Owners. The Participants and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. The State Treasurer will not have any responsibility or obligation to such Participants or the persons for whom they act as nominees with respect to the Offered Veterans G.O. Bonds.

Beneficial Owners of the Offered Veterans G.O. Bonds may wish to take certain steps to augment transmission to them of notices of significant events with respect to the Offered Veterans G.O. Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Offered Veterans G.O. Bond documents. Beneficial Owners of the Offered Veterans G.O. Bonds may wish to ascertain that the nominee holding the Offered Veterans G.O. Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners, or in the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of the notices be provided directly to them.

Redemption notices shall be sent to Cede & Co. If less than all of a maturity of the Offered Veterans G.O. Bonds is being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to Offered Veterans G.O. Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to the issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Offered Veterans G.O. Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Without limiting the generality of the foregoing, the State Treasurer and the Underwriters have no responsibility or liability for any aspects of the records relating to or payments made on account of beneficial ownership, or for maintaining, supervising or reviewing any records relating to beneficial ownership, or interests in the Offered Veterans G.O. Bonds.

Principal, premium and interest payments on the Offered Veterans G.O. Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the State Treasurer, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name" and will be the responsibility of such Participant and not of DTC (nor its nominee) or the State Treasurer, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to DTC is the responsibility of the State Treasurer, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

The State Treasurer and the Underwriters cannot and do not give any assurances that DTC, Participants or others will distribute payments with respect to the Offered Veterans G.O. Bonds received by DTC or its nominee as the registered owner, or any prepayment or other notices, to the Beneficial

Owners, or that they will do so on a timely basis, or that DTC will serve and act in the manner described in this Official Statement.

The State Treasurer may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, bond certificates will be printed and delivered. DTC may discontinue providing its services as securities depository with respect to the Offered Veterans G.O. Bonds at any time by giving reasonable notice to the State Treasurer.

Under such circumstances, in the event that a successor securities depository is not obtained, bond certificates are required to be printed and delivered.

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## APPENDIX D

### SUMMARY OF CONTINUING DISCLOSURE CERTIFICATES

#### STATE TREASURER'S DISCLOSURE CERTIFICATE

The State Treasurer, on behalf of the State, will execute for the Offered Veterans G.O. Bonds a Continuing Disclosure Certificate (the "Treasurer's Disclosure Certificate"). The following is a summary of the provisions of the Treasurer's Disclosure Certificate. Such summary is qualified by reference to the complete Treasurer's Disclosure Certificate, which is available from the Office of the State Treasurer.

#### Definitions

Pursuant to the Treasurer's Disclosure Certificate, the following definitions will apply:

**"Annual Report"** shall mean the Annual Report filed by the State Treasurer pursuant to, and as described in, the Treasurer's Disclosure Certificate.

**"Beneficial Owner"** shall mean any person which has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any applicable Offered Veterans G.O. Bonds (including persons holding applicable Offered Veterans G.O. Bonds through nominees, depositories or other intermediaries).

**"Dissemination Agent"** shall mean the State Treasurer, acting in its capacity as Dissemination Agent under the Treasurer's Disclosure Certificates, or any successor Dissemination Agent designated in writing by the State Treasurer.

**"Holder"** shall mean any person listed on the registration books of the State Treasurer as the registered owner of any applicable Offered Veterans G.O. Bonds.

**"Listed Events"** shall mean any of the events listed below under "Reporting of Significant Events."

**"National Repository"** shall mean any Nationally Recognized Municipal Securities Information Repository certified by the Securities and Exchange Commission to be the recipient of information of the nature of the Annual Reports required by the Treasurer's Disclosure Certificate.

**"Official Statement"** shall mean the Official Statement relating to the original issuance of the Offered Veterans G.O. Bonds.

**"Repository"** shall mean each National Repository and the State Repository.

**"Rule"** shall mean Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

**"State"** shall mean the State of California.

**"State Repository"** shall mean any public or private repository or entity within the State created for the purpose of receiving information of the nature of the Annual Reports or reports of material events required by the Treasurer's Disclosure Certificate and recognized as such by the Securities and Exchange Commission. As of the date of this Official Statement, there is no State Repository.

## **Annual Reports**

The State Treasurer on behalf of the State shall, not later than April 1 of each year in which the applicable Offered Veterans G.O. Bonds are outstanding, commencing with the report for the next Fiscal Year, provide an Annual Report consistent with the requirements of the Treasurer's Disclosure Certificate (an "Annual Report") to each Repository; provided that the audited financial statements of the State may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. The State Treasurer shall make a copy of any Annual Report available to any person who requests a copy at a cost not exceeding the reasonable cost of duplication and delivery.

If in any year, the State Treasurer does not provide the Annual Report to each Repository by the time specified above, the State Treasurer shall instead file a notice with each Repository stating that the Annual Report has not been timely completed and, if known, stating the date by which the State Treasurer expects to file the Annual Report.

The Annual Report shall contain or include by reference the following:

(2) The audited General Purpose Financial Statements of the State for the fiscal year ended on the previous June 30, prepared in accordance with generally accepted accounting principles promulgated to apply to government entities from time to time by the Governmental Accounting Standards Board. If the State's audited financial statements are not available by the time the Annual Report is required to be filed pursuant to the Treasurer's Disclosure Certificate, the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the applicable final Official Statement, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.

(3) Financial information relating to the State's General Fund budget for the fiscal year ended on the previous June 30 and information concerning the State budget for the fiscal year in which the Annual Report is issued. Such information shall describe the sources of revenues, the principal categories of expenditures, and changes in fund balances, a summary of expected State revenues and budgeted expenditures, and significant assumptions relating to revenue and expenditure expectations, including updating the following tables which appear under the caption APPENDIX A - "THE STATE OF CALIFORNIA - Current State Budget" in the Official Statement:

### **Table Entitled**

Summary of State Revenues and Expenditures  
Revenue and Expenditure Assumptions

(4) Information concerning the total amount of the State's authorized and outstanding debt, long-term lease obligations and other long-term liabilities as of the end of the most recent June 30, which debt is supported by payments from the State's General Fund and which includes short-term debt. Such information shall include schedules of debt service for outstanding general obligation bonds and lease-purchase debt. This shall be accomplished by updating the following tables which appear under the caption APPENDIX A - "THE STATE OF CALIFORNIA - State Indebtedness" in the Official Statement.

### **Table Entitled**

Authorized and Outstanding General Obligation Bonds  
Outstanding State Debt

Schedule of Debt Service Requirements for General Fund  
General Obligation Bonds

Schedule of Debt Service Requirements for  
Enterprise Fund General Obligation Bonds

Schedule of Debt Service Requirements for  
Lease-Purchase Debt

State Public Works Board and  
Other Lease-Purchase Financing Outstanding Issues

State Agency Revenue Bonds and  
Conduit Financing

The Annual Report may consist of one or more documents. Any or all of the items listed above may be included in the Annual Report by reference to other documents which have been filed by the State with each of the Repositories, including any final official statement (in which case such final official statement must also be available from the Municipal Securities Rulemaking Board). The State Treasurer shall clearly identify in the Annual Report each such document so included by reference.

### **Reporting of Significant Events**

The State Treasurer, on behalf of the State shall give, or cause to be given, prompt notice of the occurrence of any of the following events with respect to the Offered Veterans G.O. Bonds (hereafter referred to as a "Listed Event"), if material:

2. principal and interest payment delinquencies;
3. non-payment related defaults;
4. modifications to rights of Bondholders;
5. optional, contingent or unscheduled bond calls;
6. defeasances;
7. rating changes;
8. adverse tax opinions or events affecting the tax-exempt status of the applicable Offered Veterans G.O. Bonds;
9. unscheduled draws on debt service reserves reflecting financial difficulties;
10. unscheduled draws on credit enhancements reflecting financial difficulties;
11. substitution of credit or liquidity providers, or their failure to perform; or
12. release, substitution or sale of property securing repayment of the applicable Offered Veterans G.O. Bonds.

The State Treasurer shall timely file a notice of each such occurrence, if it is material under applicable federal securities laws, with the Municipal Securities Rulemaking Board and each Repository. The State notes that items 8, 9, 10 and 11 above are not applicable to the Offered Veterans G.O. Bonds.

### **Other Provisions**

*Termination of Reporting Obligation.* The State's obligations under the Treasurer's Disclosure Certificates shall terminate upon the maturity, legal defeasance, prior redemption or acceleration of all of the applicable outstanding Offered Veterans G.O. Bonds.

*Dissemination Agent.* The State Treasurer may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out the obligations under the Treasurer's Disclosure Certificate, and may discharge any such Dissemination Agent, with or without appointing a successor

Dissemination Agent. If at any time there is not any other designated Dissemination Agent, the State Treasurer shall be the Dissemination Agent. The initial Dissemination Agent shall be the State Treasurer.

*Amendment; Waiver.* Notwithstanding any other provision of the Treasurer's Disclosure Certificates, the State Treasurer may amend or waive any provision of the Treasurer's Disclosure Certificates, provided that the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions of the Treasurer's Disclosure Certificate dealing with the timing or content of the Annual Report or the giving of notice of Listed Events, it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law or change in the identity, nature or status of an obligated person with respect to the applicable Offered Veterans G.O. Bonds, or the type of business conducted;

(b) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original issuance of the applicable Offered Veterans G.O. Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver either (i) is approved by the Holders of sixty percent (60%) of the applicable Offered Veterans G.O. Bonds, or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Holders or Beneficial Owners of the applicable Offered Veterans G.O. Bonds.

*Additional Information.* Nothing in the Treasurer's Disclosure Certificate shall be deemed to prevent the State Treasurer from disseminating any other information, using the means of dissemination set forth in the Treasurer's Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by the Treasurer's Disclosure Certificate. If the State Treasurer chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by the Treasurer's Disclosure Certificate, the State Treasurer shall not have any obligation to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

*Beneficiaries.* The Treasurer's Disclosure Certificate shall inure solely to the benefit of the Holders and Beneficial Owners from time to time of the Offered Veterans G.O. Bonds, and shall create no rights in any other person or entity (except the right of any Bondholder or Beneficial Owner to enforce the provisions of the Treasurer's Disclosure Certificate on behalf of the Bondholders). The Treasurer's Disclosure Certificate is not intended to create any monetary rights on behalf of any person based upon the Rule. The sole remedy in the event of any failure of the State Treasurer to comply with the Treasurer's Disclosure Certificate shall be an action to compel performance of any act required thereunder.

## DEPARTMENT'S DISCLOSURE CERTIFICATE

The Secretary of Veterans Affairs (the "Secretary"), on behalf of the Department, will execute a Continuing Disclosure Certificate (the "Department's Disclosure Certificate") for the Offered Veterans G.O. Bonds. The following is a summary of the Department's Disclosure Certificate. Such summary is qualified by reference to the complete Department's Disclosure Certificate, which is available from the Department.

### **Certain Definitions**

Defined terms used in the Department's Disclosure Certificate and not otherwise defined therein have the meanings set forth elsewhere in this Official Statement.

**"Beneficial Owner"** means a Beneficial Owner of Subject Bonds, as determined pursuant to the Rule.

**"Bonds"** means, at any time, all of the State's then Outstanding Offered Veterans G.O. Bonds, collectively.

**"Fiscal Year"** means that period established by the Department with respect to which its, as applicable, Audited Financial Statements or Unaudited Financial Statements are prepared. As of the date of the Department's Disclosure Certificate, the Department's Fiscal Year begins on July 1 and ends on June 30 of the next calendar year.

**"Holders"** means the registered owners of the Subject Bonds.

**"MSRB"** means the Municipal Securities Rulemaking Board established pursuant to Section 15B(b)(1) of the Securities Exchange Act of 1934, as amended.

**"Notice"** means written notice, sent for overnight delivery via the United States Postal Service or a private delivery service which provides evidence of delivery.

**"Notice Address"** means with respect to the Department:

State of California Department of Veterans Affairs  
1227 O Street  
Sacramento, CA 95814  
Attention: Bond Finance Division

**"NRMSIR"** means, at any time, a then-existing nationally recognized municipal securities information repository, as recognized from time to time by the SEC for the purposes referred to in the Rule.

**"Official Statement"** means the Official Statement relating to the original issuance of the Offered Veterans G.O. Bonds.

**"Rule"** means the applicable provisions of Rule 15c2-12 promulgated by the SEC under the Securities Exchange Act of 1934, as amended (17 CFR Part 240, § 240.15c2-12), as in effect on the date of the Department's Disclosure Certificate, including any official interpretations thereof.

**"SEC"** means the United States Securities and Exchange Commission.

**"Securities Counsel"** means legal counsel expert in federal securities laws.



"SID" means, at any time, a then-existing state information depository, if any, as operated or designated as such by or on behalf of the State and recognized by the SEC for the purposes referred to in the Rule.\*

"Subject Bonds" means those Offered Veterans G.O. Bonds and those Veterans G.O. Bonds subject to the same Department's Disclosure Certificate.

### **Provision of Annual Financial Information**

The Department will, not later than the first day of the tenth calendar month after the end of each of the Department's Fiscal Years, commencing with the report for the 2000-2001 Fiscal Year, provide to the State Treasurer and to each NRMSIR and the SID the Annual Financial Information (as described hereinbelow). The audited financial statements of the Department may be submitted separately from the balance of the Annual Financial Information, and later than the date required for the filing of the Annual Financial Information if not available by that date.

The Department's Disclosure Certificate requires the Department to provide, in a timely manner, notice of any failure by it to provide Annual Financial Information to each NRMSIR and the SID on or before the date described in the first paragraph under this heading, to the SID, to the State Treasurer, and to either (i) each NRMSIR or (ii) the MSRB.

### **Content of Annual Financial Information**

The Department's Annual Financial Information shall contain or include by reference the following:

(a) financial information or operating data of the types included in EXHIBIT 2 to APPENDIX B of the Official Statement entitled "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA"; and

(b) the audited financial statements of the 1943 Fund for the Fiscal Year ended on the previous June 30, prepared in accordance with generally accepted accounting principles established by the Financial Accounting Standards Board, if available, or unaudited financial statements for such Fiscal Year.

If not provided as part of the Annual Financial Information by the date required (as described above under "Provision of Annual Financial Information"), the Department shall provide audited financial statements, when and if available, to the State Treasurer and to each NRMSIR and the SID.

Any or all of the items listed above may be included by specific reference to other documents, including official statements of debt issues of the Department or related public entities, which have been submitted to each NRMSIR and the SID or the SEC. (If such document is an official statement, it must also be available from the MSRB.) Annual Financial Information may be provided in one document or multiple documents, and at one time or in part from time to time.

### **Additional Information**

Nothing in the Department's Disclosure Certificate will be deemed to prevent the Department from disseminating any other information, using the means of dissemination set forth in such Department's Disclosure Certificate or any other means of communication, or including any other information in any

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\* As of the date of this Official Statement, there is no SID.

Annual Financial Information, in addition to that which is required by the Department's Disclosure Certificate. If the Department chooses to include any information in any Annual Financial Information in addition to that which is specifically required by the Department's Disclosure Certificate, the Department will have no obligation under the Department's Disclosure Certificate to update such information or include it in any future Annual Financial Information.

#### **Amendment of Department's Disclosure Certificate**

The Department's Disclosure Certificate may be amended and any provision of the Department's Disclosure Certificate be waived, without the consent of the Holders or Beneficial Owners, except as described in clause 4 (ii) below, under the following conditions: (1) such amendment or waiver is made in connection with a change in circumstances that arises from a change in legal (including regulatory) requirements, a change in law (including rules or regulations) or in interpretations thereof, or a change in the identity, nature or status of the Department or the type of business conducted thereby, (2) the Department's Disclosure Certificate as so amended or waived would have complied with the requirements of the Rule as of the date of each primary offering of Subject Bonds affected by such amendment or waiver, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances, (3) the Department shall have obtained an opinion of Securities Counsel, addressed to the Department and the State Treasurer, to the same effect as set forth in clause (2) above, (4) either (i) a party unaffiliated with the Department (such as bond counsel), acceptable to the Department, has determined that the amendment or waiver does not materially impair the interests of the Beneficial Owners, or (ii) the applicable Holders consent to the amendment to or waiver of such Department's Disclosure Certificate, and (5) the Department shall have delivered copies of such amendment or waiver to the SID, to the State Treasurer, and to either each NRMSIR or the MSRB.

In addition to the foregoing, the Department may amend the Department's Disclosure Certificate, and any provision of the Department's Disclosure Certificate may be waived, if the Department shall have received an opinion of Securities Counsel, addressed to the Department and the State Treasurer, to the effect that the adoption and the terms of the amendment or waiver would not, in and of themselves, cause the undertakings in such Department's Disclosure Certificate to violate the Rule, taking into account any subsequent change in or official interpretation of the Rule.

#### **Benefit; Enforcement**

The provisions of the Department's Disclosure Certificate will inure solely to the benefit of the Holders and Beneficial Owners from time to time.

Except as described in this paragraph, the provisions of the Department's Disclosure Certificate will create no rights in any other person or entity. The obligation of the Department to comply with the provisions of the Department's Disclosure Certificate is enforceable (i) in the case of enforcement of obligations to provide financial statements, financial information, operating data, and notices, by any Beneficial Owner of outstanding Subject Bonds, or (ii) in the case of challenges to the adequacy of the financial statements, financial information, and operating data so provided, by the Holders of not less than twenty-five percent (25%) in aggregate principal amount of the Subject Bonds at the time Outstanding.

The right to enforce the provisions of the Department's Disclosure Certificate is limited to a right, by action in mandamus or for specific performance, to compel performance of the Department's obligations under the Department's Disclosure Certificate. Any failure by the Department to perform in accordance with the Department's Disclosure Certificate will not constitute a default under the Subject

Bonds, and the rights and remedies provided by the Subject Bonds upon the occurrence of a default will not apply to any such failure.

#### **Termination of Reporting Obligation**

The Department's obligations under the Department's Disclosure Certificate with respect to the Subject Bonds terminate upon the legal defeasance, prior redemption, or payment in full of all of such Subject Bonds. The Department shall give notice of any such termination to the SID and to either each NRMSIR or the MSRB.

The Department's Disclosure Certificate, or any provision thereof, will be null and void to the extent set forth in the opinion of Securities Counsel obtained by the Department and addressed to the Department and the State Treasurer, to the effect that those portions of the Rule which require the provisions of such Department's Disclosure Certificate, or any of such provisions, do not or no longer apply to the applicable Subject Bonds, whether because such portions of the Rule are invalid, have been repealed, or otherwise, as will be specified in such opinion, and the Department delivers notice to such effect to the State Treasurer, to the SID and to either each NRMSIR or the MSRB.

#### **Governing Law**

The Department's Disclosure Certificate will be construed and interpreted in accordance with the laws of the State, and any suits and actions arising out of the Department's Disclosure Certificate will be instituted in a court of competent jurisdiction in the State, *provided that*, to the extent such Department's Disclosure Certificate addresses matters of federal securities laws, including the Rule, the Department's Disclosure Certificate will be construed in accordance with such federal securities laws and official interpretations thereof.

## APPENDIX E

### CERTAIN FEDERAL TAX CODE REQUIREMENTS

The Federal Tax Code restricts the issuance of Federally tax-exempt bonds to finance mortgage loans for single family housing or to refund such bonds.

Those Federal Tax Code restrictions are not the same for all such tax-exempt bonds. There are three types of such tax-exempt bonds: (i) qualified mortgage bonds, which provide Qualified Mortgage Bond Proceeds, (ii) qualified veterans' mortgage bonds, which provide Qualified Veterans' Mortgage Bond Proceeds, and (iii) pre-Ullman bonds, which provide Unrestricted Moneys. Revenue Bonds may be either qualified mortgage bonds or pre-Ullman Bonds. ("Pre-Ullman bonds" are bonds issued before 1981, or bonds issued to refund such bonds.) Veterans G.O. Bonds may be either qualified veterans' mortgage bonds or pre-Ullman bonds. The principal Federal Tax Code restrictions relate to: (i) the use of proceeds of the bond issue, (ii) the yield on the financed mortgage loans and from certain non-mortgage investments related to the issue, (iii) for qualified mortgage bonds and qualified veterans' mortgage bonds, loan eligibility requirements, (iv) for qualified mortgage bonds, the availability of proceeds of the issue for financing housing located in "targeted areas," and (v) certain matters relating to the issue itself.

See "TAX MATTERS" for information regarding the requirements applicable to the Offered Veterans G.O. Bonds.

Failure to comply with the applicable provisions of the Federal Tax Code may result in interest on the applicable issue of bonds being included in gross income for federal income tax purposes retroactive to the date of issuance thereof.

#### ***Loan Eligibility Requirements Imposed by the Federal Tax Code on Qualified Mortgage Bond Proceeds and Qualified Veterans' Mortgage Bond Proceeds***

##### ***Qualified Mortgage Bond Proceeds***

The Federal Tax Code contains the following loan eligibility requirements with respect to Qualified Mortgage Bond Proceeds, except that the requirements described under "First-Time Homebuyer Requirement," "Purchase Price Limitation," and "Other Requirements Imposed by the Code – Recapture Provision" do not apply to home improvement loans, and the requirements described under "Qualified Home Improvement Loans" do not apply to loans for the acquisition of single family homes. None of those requirements applies to pre-Ullman bonds or qualified veterans' mortgage bonds.

**Residence Requirement.** The Federal Tax Code requires that each of the premises financed with the lendable proceeds of qualified mortgage bonds be a one-to-four-family residence, one unit of which can reasonably be expected to become the principal residence of the veteran within a reasonable time after the financing is provided. Certain documents adopted by the Department establish procedures to be followed in connection with Contracts of Purchase which finance the acquisition of single family homes in order to assure that interest paid on the qualified mortgage bonds not be included in gross income for Federal income tax purposes under the Federal Tax Code (the "Single Family Program Documents"). Certain documents adopted by the Department establish procedures to be followed in connection with Contracts of Purchase to finance home improvement loans in order to assure that interest paid on the qualified mortgage bonds is not included in gross income for Federal income tax purposes under the Federal Tax Code (the "Home Improvement Program Documents," together with the Single Family Program Documents, the "Program Documents"). In connection with the financing of a Contract of

Purchase, the Program Documents require that each veteran submit an affidavit stating such person's intention to occupy the premises as his principal residence within 60 days after closing of the Contract of Purchase.

First-Time Homebuyer Requirement. The Federal Tax Code requires that, subject to certain exceptions, the lendable proceeds of qualified mortgage bonds be used to provide financing to borrowers who have not had a present ownership interest in their principal residence during the three-year period prior to execution of the mortgage loan. This limitation, however, does not apply to the mortgagor's interest in the residence being financed or to certain residences in certain Presidentially-declared disaster areas; and all financing with respect to targeted area residences and residences on land possessed under certain contract for deed agreements is treated as satisfying the first time homebuyer requirement. Veterans subject to this requirement are required to provide federal income tax returns for the previous three years or other appropriate certifications to allow verification that no deductions or other entries have been made that would indicate any such ownership interest.

New Mortgage Requirement. The Federal Tax Code requires that, with certain limited exceptions, the lendable proceeds of qualified mortgage bonds finance new mortgage loans only and that no proceeds may be used to acquire or replace an existing mortgage loan, which would include the refinancing of a pre-existing mortgage loan. The Program Documents state that the Department will verify compliance with the new mortgage requirement by requiring each veteran to certify prior to financing, subject to such exceptions, that no refinancing of a prior mortgage loan is being effected.

Purchase Price Limitation. The Federal Tax Code requires that the purchase price of the residence financed with the lendable proceeds of qualified mortgage bonds may not exceed 90% of the average area purchase price applicable to such residence or 110% of the applicable average area purchase price in the case of residences located in targeted areas or residences in certain Presidentially-declared disaster areas. The Program Documents state that the Department will verify compliance with the purchase price limitations by requiring each veteran and seller of a residence to make certifications regarding the purchase price of such residence.

Income Limitation. The Federal Tax Code requires that all mortgage loans made from the lendable proceeds of qualified mortgage bonds be made only to borrowers whose family income does not exceed 115% (for mortgage loans made to families with fewer than three members, 100%) of the applicable median family income. An exception is provided for mortgage loans financed with the lendable proceeds of qualified mortgage bonds made with respect to targeted area residences and residences in certain Presidentially-declared disaster areas that permits two-thirds in aggregate amount of such mortgage loans to be made with respect to borrowers whose family income does not exceed 140% (for mortgage loans made to families with fewer than three members, 120%) of the applicable median family income and one-third in aggregate amount of such loans to be made without regard to any income limitation.

Federal tax law permits higher income limits for persons financing homes located in certain "high housing cost areas." A high housing cost area is a statistical area for which the ratios of the area's average purchase price for existing and new single family houses to the area's median income exceed 120% of the same ratios determined on a national basis. These ratios are determined separately with respect to new and existing single family residences. An area is a high housing cost area only if the ratios for both new and existing houses meet the 120% test. In high housing cost areas, the veteran income limits are increased above 115% (or 100%, as applicable) by one percent for each percentage point (1%) by which the new or existing housing price ratio, whichever is smaller, exceeds 120%. However, the new limit

cannot exceed 140% (or 120%, as applicable) of the income limits otherwise applicable. Certain areas of the State may qualify as high housing cost areas.

Family income includes income of all individuals executing both the note and mortgage and occupying the dwelling as their principal residence.

Requirements as to Assumptions. The Federal Tax Code provides that a mortgage loan may be assumed only if each of the then applicable residence requirements, first-time-homebuyer requirement, purchase price limitation, and income limitation is met with respect to such assumption. The Contracts of Purchase contain a "due on sale" clause, and the Department will not permit the assumption of a Contract of Purchase unless it has determined that these requirements have been met and has obtained the appropriate certifications.

Qualified Home Improvement Loans. The Federal Tax Code requires that a home improvement loan financed with the lendable proceeds of qualified mortgage bonds not exceed \$15,000, be made only with respect to an owner-occupied residence, and finance alterations, repairs, and improvements on or in connection with an existing one-to-four-family residence by the owner thereof, but only if such alterations, repairs and improvements substantially protect or improve the basic livability or energy efficiency of the property.

General. Qualified mortgage bonds treated under the Federal Tax Code as one bond issue for federal tax purposes ("qualified mortgage issue") are deemed to meet the loan eligibility requirements of the Federal Tax Code if (i) the issuer in good faith attempted to meet all the loan eligibility requirements before the mortgage loans were executed, (ii) any failure to comply with the loan eligibility requirements is corrected within a reasonable period after such failure is first discovered, and (iii) 95% or more of the proceeds of the issue used to make mortgage loans was used to finance residences that met all such requirements at the time the mortgage loans were executed. In determining whether 95% or more of the proceeds has been so used, the Federal Tax Code permits the Department to rely on an affidavit of the veteran and of the seller as to the purchase price of a residence and an affidavit of the veteran and an examination of copies of the veteran's Federal income tax returns for the last three years preceding the date the Contract of Purchase is or was executed even though the relevant information in such affidavits and income tax returns should ultimately prove to be untrue, unless the Department knows or has reason to believe that such information is false.

#### *Qualified Veterans' Mortgage Bond Proceeds*

The Federal Tax Code requires that each mortgagor to whom financing is provided under a qualified veterans' mortgage bond issue have served on active duty at some time before January 1, 1977 and apply for financing before the later of January 31, 1985 or the date which is 30 years after the last date on which the veteran left active service. The Department has established and has covenanted to comply with such requirements.

Generally, only the loan eligibility requirements stated above under "Qualified Mortgage Bond Proceeds - Residence Requirement," "- New Mortgage Requirement" and "- Qualified Home Improvement Loans" (*except* the \$15,000 maximum loan amount) apply to Qualified Veterans' Mortgage Bond Proceeds.

#### *Other Requirements Imposed by the Federal Tax Code*

General. The Federal Tax Code provides that gross income for federal income tax purposes does not include interest on a mortgage revenue bond if it is a qualified mortgage bond or a qualified veterans'

mortgage bond. A qualified mortgage bond is a part of an issue of a state or political subdivision all the proceeds of which (net of amounts applied to any costs of issuance thereof and to fund a reasonably required reserve) are used to finance (or to refund bonds all of such net proceeds of which were used to finance) owner-occupied residences and that meets certain (i) general requirements, (ii) arbitrage restrictions on the use and investment of proceeds of the issue, and (iii) loan eligibility requirements set forth in the Federal Tax Code and as more fully described above under "Loan Eligibility Requirements Imposed by the Federal Tax Code." A qualified veterans' mortgage bond is part of an issue 95 percent or more of the net proceeds of which are used to provide residences to veterans and that meets certain (i) general requirements, (ii) arbitrage restrictions on the use and investment of proceeds of the issue, and (iii) loan eligibility requirements set forth in the Federal Tax Code and as more fully described above under "Loan Eligibility Requirements Imposed by the Federal Tax Code."

Volume Limitation, Targeted Area and Required Reports. The first general requirement of the Federal Tax Code, applicable to qualified mortgage bonds, is that the aggregate amount of private activity bonds (exclusive of qualified veterans' mortgage bonds) that may be issued by the Department in any calendar year (or previous years' carried forward amount) must not exceed the portion of the private activity bond volume limit for the State for such calendar year that is allocated by the State to the Department. With respect to qualified veterans' mortgage bonds, a separate limit is based on statutory formulae. The second general requirement of the Federal Tax Code applicable to qualified mortgage bonds is that at least 20% of the lendable proceeds of an issue of bonds which are not refunding bonds (if such set-aside was satisfied with respect to the bonds being refunded) must be made available (and applied with reasonable diligence) for owner-financing of residences in targeted areas (as defined by the Federal Tax Code) for at least one year after the date on which such funds are first available for such owner-financing (the "targeted area requirement"). The third general requirement of the Federal Tax Code requires the issuer of qualified mortgage bonds and qualified veterans' mortgage bonds to file with the Internal Revenue Service reports on the issuance of its qualified mortgage bonds or qualified veterans mortgage bonds following such issuance, as well as an annual qualified mortgage loan information report.

Yield Limitations and Rebate. The Federal Tax Code requires that the effective interest rate on mortgage loans financed with the lendable proceeds of qualified mortgage bonds and qualified veterans' mortgage bonds may not exceed the yield on the issue by more than 1.125% (1.50% for pre-Ullman bonds), and that certain investment earnings on non-mortgage investments, calculated based upon the extent such investment earnings exceed the amount that would have been earned on such investments if the investments were invested at a yield equal to the yield on the issue, be rebated to the United States or to veterans. These requirements apply to both Revenue Bonds and Veterans G.O. Bonds, except that for Veterans G.O. Bonds, rebate, absent an election to pay to the United States, is to veterans. The Department has established procedures to determine the amount of excess earnings, if any, that must be rebated to the United States or to veterans. See APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND" and "–THE PROGRAM – Contracts of Purchase" for discussions of provisions of the Veterans Code which affect the Department's ability to establish and to change interest rates on Contracts of Purchase.

Recapture Provision Applicable to Qualified Mortgage Bonds. For certain mortgage loans made after December 31, 1990 from the lendable proceeds of qualified mortgage bonds issued after August 15, 1986, and for assumptions of such mortgage loans, the Federal Tax Code requires a payment to the United States from certain borrowers upon sale or other disposition of their homes (the "Recapture Provision"). The Recapture Provision requires that an amount determined to be the subsidy provided by a qualified mortgage bond financing to a borrower be paid to the United States on disposition of the residence (but not in excess of 50% of the gain realized by the borrower). The recapture amount would

(i) increase over the period of ownership, with full recapture occurring if the residence were sold between four and five full years after the closing of the mortgage loan and (ii) decline ratably to zero with respect to sales occurring between five and nine full years after the closing of the mortgage loan. An exception excludes from recapture part or all of the subsidy in the case of certain assisted individuals whose incomes are less than prescribed amounts at the time of the disposition. The Federal Tax Code requires an issuer to inform borrowers of certain information with respect to the Recapture Provision.

Required Redemptions. For qualified mortgage bonds issued after 1988, the Federal Tax Code permits repayments (including prepayments) of principal of mortgage loans financed with the proceeds of an issue of such bonds to be used to make additional mortgage loans for only 10 years from the date of issuance of the bonds (or the date of issuance of the original bonds in the case of refundings), after which date such amounts must be used to redeem bonds, except for a \$250,000 *de minimis* amount (the "10-Year Rule"). As a result, the Department is required by the Federal Tax Code to redeem Revenue Bonds which are qualified mortgage bonds from repayments (including prepayments) of principal of certain Contracts of Purchase not later than the close of the semi-annual period after the payment is received. See "TAX MATTERS – Federal Tax Matters – Proposed Federal Tax Legislation."

Compliance. The Federal Tax Code states that an issuer will be treated as meeting the targeted area requirement, the arbitrage restrictions on mortgage loans, and the recapture information requirements if it in good faith attempted to meet all such requirements and any failure to meet such requirements was due to inadvertent error after taking all reasonable steps to comply with such requirements.



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**APPENDIX F**  
**LEGAL OPINION OF ATTORNEY GENERAL**

**Bill Lockyer**  
**Attorney General**  
**STATE OF CALIFORNIA**  
**1300 I Street, Suite 1101**  
**Sacramento, California 95814**

*(Closing Date)*

Office of the Treasurer of the State  
of California  
915 Capitol Mall, Room 235  
Sacramento, California 95814

Ladies and Gentlemen:

The undersigned, Attorney General of the State of California (the "State"), has examined upon request copies of proceedings taken by the State in connection with the issuance of the State's \$42,000,000 aggregate principal amount Veterans General Obligation Bonds, Series BX (the "Series BX Bonds") and the sale of the Series BX Bonds to the initial purchasers thereof. The Series BX Bonds are issued pursuant to (i) the Veterans Bond Act of 1996 (the "Law"), which was approved by the electors of the State, (ii) Part 3 of Division 4 of Title 2 of the California Government Code, and (iii) Resolution IV under the Law (the "Resolution"), adopted by the Veterans Finance Committee of 1943 on February 21, 2001.

The Series BX Bonds are dated, mature on the dates in the principal amounts, bear interest, if any, and are payable as provided in the Resolution. The Series BX Bonds are subject to redemption prior to maturity in whole or in part as provided in the Resolution.

In connection with the issuance of the Series BX Bonds, the undersigned has examined (a) a copy of the Resolution, and (b) such other opinions, documents, certificates and letters as we deem relevant and necessary in rendering this opinion.

From such examination, the undersigned is of the opinion that the State has lawful authority for the issuance of the Series BX Bonds, and the Series BX Bonds constitute the valid and legally binding general obligations of the State payable in accordance with the Law from the General Fund of the State. The full faith and credit of the State of California are pledged for the punctual payment of the principal of and interest on the Series BX Bonds.

In rendering this opinion, we advise you that the enforceability of the Series BX Bonds and the Resolution may be limited by bankruptcy, insolvency, reorganization, moratorium, arrangement, fraudulent conveyance and other laws relating to or affecting creditors' rights or remedies, to the application of equitable principles (regardless of whether such enforceability is considered in a proceeding in equity or at law), to the exercise of judicial discretion in appropriate cases and to limitations on legal remedies against the State of California and its subdivisions and departments.

Very truly yours,

BILL LOCKYER,  
ATTORNEY GENERAL

By: \_\_\_\_\_  
Deputy Attorney General

**APPENDIX G**  
**LEGAL OPINION OF BOND COUNSEL**

**Hawkins, Delafield & Wood**  
633 West Fifth Street  
Los Angeles, California 90071

*(Closing Date)*

Office of the Treasurer of the State  
of California  
915 Capitol Mall, Room 235  
Sacramento, California 95814

Ladies and Gentlemen:

We have acted as bond counsel to the State of California (the "State"), and in such capacity we have examined upon request copies of proceedings taken by the State in connection with the issuance of the State's \$42,000,000 aggregate principal amount Veterans General Obligation Bonds, Series BX (the "Bonds") and the sale of the Bonds to the initial purchasers thereof. The Bonds are issued pursuant to (i) the Veterans Bond Act of 1996 (the "Law"), which was approved by the electors of the State, (ii) Part 3 of Division 4 of Title 2 of the California Government Code, and (iii) Resolution IV under the Law (the "Resolution"), adopted by the Veterans Finance Committee of 1943 on February 21, 2001.

The Bonds are dated, mature on the dates in the principal amounts, bear interest, if any, and are payable as provided in the Resolution. The Bonds are subject to redemption prior to maturity in whole or in part as provided in the Resolution.

Applicable federal tax law establishes certain requirements that must be met subsequent to the issuance of the Bonds in order that interest on the Bonds not be included in gross income for Federal income tax purposes under the Internal Revenue Code of 1986, as amended (the "Code"). The Department of Veterans Affairs of the State of California (the "**Department**") **has adopted** documents with respect to its program (the "Program Documents") that establish procedures under which, if followed, such requirements can be met. The State and the Department have covenanted in the Resolution and in tax certificates and other documents applicable to the issuance of the Bonds (collectively with the Program Documents, the "Documents"), to all times perform all acts and things permitted by law and necessary and desirable in order to assure that interest paid on the Bonds shall not be included in gross income for Federal income tax purposes under the Code. In rendering this opinion, we have relied upon such covenants and have assumed compliance by the State and the Department with the provisions of such Documents.

In connection with the issuance of the Bonds, we have examined (a) a copy of the Resolution and (b) such other opinions, documents, certificates and letters as we deem relevant and necessary in rendering this opinion.

From such examination, we are of the opinion that:

i) The State has lawful authority for the issuance of the Bonds, and the Bonds constitute the valid and legally binding general obligations of the State payable in accordance with the Law from the General Fund of the State. The full faith and credit of the State of California are pledged for the punctual payment of the principal of and interest on the Bonds.

ii) Under existing statutes and court decisions and assuming compliance with certain tax covenants described herein, interest on the Bonds is not included in gross income for Federal income tax purposes pursuant to Section 103 of the Code, and is not treated as a preference item for purposes of calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, *however*, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations.

iii) Interest on the Bonds is exempt from State personal income taxation under present State law.

In rendering this opinion, we express no opinion regarding any other Federal or state tax consequences with respect to the Bonds. We render this opinion under existing statutes and court decisions as of the issue date, and assume no obligation to update this opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise. In rendering this opinion, we express no opinion on the effect of any action taken after the date of the opinion or not taken in reliance upon an opinion of other counsel on the exclusion from gross income for Federal income tax purposes of interest on the Bonds, or under state and local tax law.

In rendering this opinion, we are advising you that the enforceability of the Bonds may be limited by bankruptcy, moratorium, insolvency, or other laws affecting creditors' rights or remedies and is subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

Very truly yours,

## **APPENDIX H**

### **FORM OF OFFERED VETERANS G.O. BONDS MUNICIPAL BOND INSURANCE POLICY OF FINANCIAL SECURITY ASSURANCE INC.**

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**FINANCIAL  
SECURITY  
ASSURANCE®**

## **MUNICIPAL BOND INSURANCE POLICY**

ISSUER:

BONDS:

Policy No.: -N

Effective Date:

Premium:

FINANCIAL SECURITY ASSURANCE INC. ("Financial Security"), for consideration received, hereby UNCONDITIONALLY AND IRREVOCABLY agrees to pay to the trustee (the "Trustee") or paying agent (the "Paying Agent") (as set forth in the documentation providing for the issuance of and securing the Bonds) for the Bonds, for the benefit of the Owners or, at the election of Financial Security, directly to each Owner, subject only to the terms of this Policy (which includes each endorsement hereto), that portion of the principal of and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

On the later of the day on which such principal and interest becomes Due for Payment or the Business Day next following the Business Day on which Financial Security shall have received Notice of Nonpayment, Financial Security will disburse to or for the benefit of each Owner of a Bond the face amount of principal of and interest on the Bond that is then Due for Payment but is then unpaid by reason of Nonpayment by the Issuer, but only upon receipt by Financial Security, in a form reasonably satisfactory to it, of (a) evidence of the Owner's right to receive payment of the principal or interest then Due for Payment and (b) evidence, including any appropriate instruments of assignment, that all of the Owner's rights with respect to payment of such principal or interest that is Due for Payment shall thereupon vest in Financial Security. A Notice of Nonpayment will be deemed received on a given Business Day if it is received prior to 1:00 p.m. (New York time) on such Business Day; otherwise, it will be deemed received on the next Business Day. If any Notice of Nonpayment received by Financial Security is incomplete, it shall be deemed not to have been received by Financial Security for purposes of the preceding sentence and Financial Security shall promptly so advise the Trustee, Paying Agent or Owner, as appropriate, who may submit an amended Notice of Nonpayment. Upon disbursement in respect of a Bond, Financial Security shall become the owner of the Bond, any appurtenant coupon to the Bond or right to receipt of payment of principal or of interest on the Bond and shall be fully subrogated to the rights of the Owner, including the Owner's right to receive payments under the Bond, to the extent of any payment by Financial Security hereunder. Payment by Financial Security to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of Financial Security under this Policy.

Except to the extent expressly modified by an endorsement hereto, the following terms shall have the meanings specified for all purposes of this Policy. "Business Day" means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of New York or the Insurer's Fiscal Agent are authorized or required by law or executive order to remain closed. "Due for Payment" means (a) when referring to the principal of a Bond, payable on the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity unless Financial Security shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration and (b) when referring to interest on a Bond, payable on the stated date for payment of interest. "Nonpayment" means, in respect of a Bond, the failure of the Issuer to have provided sufficient funds to the Trustee or, if there is no Trustee, to the Paying Agent for payment in full of all principal and interest that is Due for Payment on such Bond. "Nonpayment" shall also include, in respect of a Bond, any payment of principal or interest that is Due for Payment made to an Owner by or on behalf of the Issuer which has been recovered from such Owner pursuant to the



United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction. "Notice" means telephonic or telecopied notice, subsequently confirmed in a signed writing, or written notice by registered or certified mail, from an Owner, the Trustee or the Paying Agent to Financial Security which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Owner" means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof, except that "Owner" shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds.

Financial Security may appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy by giving written notice to the Trustee and the Paying Agent specifying the name and notice address of the Insurer's Fiscal Agent. From and after the date of receipt of such notice by the Trustee and the Paying Agent, (a) copies of all notices required to be delivered to Financial Security pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to Financial Security, and shall not be deemed received until received by both and (b) all payments required to be made by Financial Security under this Policy may be made directly by Financial Security or by the Insurer's Fiscal Agent on behalf of Financial Security. The Insurer's Fiscal Agent is the agent of Financial Security only and the Insurer's Fiscal Agent shall in no event be liable to any Owner for any act of the Insurer's Fiscal Agent or any failure of Financial Security to deposit or cause to be deposited sufficient funds to make payments due under this Policy.

To the fullest extent permitted by applicable law, Financial Security agrees not to assert, and hereby waives, only for the benefit of each Owner, all rights (whether by counterclaim, setoff or otherwise) and defenses (including, without limitation, the defense of fraud, whether acquired by subrogation, assignment or otherwise, to the extent that such rights and defenses may be available to Financial Security to avoid payment of its obligations under this Policy in accordance with the express provisions of this Policy.

This Policy sets forth in full the undertaking of Financial Security, and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto. Except to the extent expressly modified by an endorsement hereto, (a) any premium paid in respect of this Policy is nonrefundable for any reason whatsoever, including payment, or provision being made for payment, of the Bonds prior to maturity and (b) this Policy may not be canceled or revoked. THIS POLICY IS NOT COVERED BY THE PROPERTY CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 26 OF THE NEW YORK INSURANCE LAW.

In witness whereof, FINANCIAL SECURITY ASSURANCE INC. has caused this Policy to be executed on its behalf by its Authorized Officer.

[Countersignature]

FINANCIAL SECURITY ASSURANCE INC.

By \_\_\_\_\_

By \_\_\_\_\_  
Authorized Officer

A subsidiary of Financial Security Assurance Holdings Ltd.  
350 Park Avenue, New York, N.Y. 10022-6022

(212) 826-0100

Form 500NY (5/90)